

INTERNAL REVENUE BULLETIN



HIGHLIGHTS OF THIS ISSUE

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

ADMINISTRATIVE

REV PROC 2019-35, page 871.

General Rules and Specifications for Substitute Forms and Schedules. This procedure provides guidelines and general requirements for the development, printing, and approval of the 2019 substitute tax forms. This procedure will be reproduced as the next revision of Publication 1167. Rev. Proc. 2018-51 is superseded.

EMPLOYEE PLANS

TD 9875, page 856.

These final regulations amend the current regulations under § 401(k) relating to hardship distributions. Section 41113 of the Bipartisan Budget Act of 2018 (BBA) directs the Secretary to remove the requirement in the current regulations that an employee's plan contributions be suspended for at least 6 months following a hardship distribution from the plan. The amendments conform the regulations with § 41113 and update the regulations to reflect BBA § 41114 and certain other statutory changes to 401(k) plans.

NOT 2019-51, page 866.

This notice sets forth updates on the corporate bond monthly yield curve, the corresponding spot segment rates for September 2019 used under § 417(e)(3)(D), the 24-month average segment rates applicable for September 2019, and the 30-year Treasury rates, as reflected by the application of § 430(h)(2)(C)(iv).

EMPLOYMENT TAX

AOD 2019-2, page 806.

In Union Pacific Railroad Company v. United States, 865 F.3d 1045 (8th Cir. 2017), rev'd No. 8:14CV237 (D. Neb. July 1, 2016), the Eighth Circuit held that lump-sum payments paid

Bulletin No. 2019-41
October 7, 2019

to unionized employees upon ratification of collective bargaining agreements ("ratification payments") are not taxable compensation under the RRTA. In *Union Pacific*, the Eighth Circuit declined to follow *Soc. Sec. Bd. v. Nierotko*, 327 U.S. 358 (1946), and other cases following it that have broadly defined payment for services under FICA. The Supreme Court subsequently rejected the same reasoning in reversing the Eighth Circuit's opinion in *BNSF Ry. Co. v. Loos*, 139 S.Ct. 893 (2019), and instead emphasized the parallels between the FICA and the RRTA schemes. This AOD provides that *Union Pacific*'s holding on ratification payments has been superseded by the Supreme Court analysis in *Loos*.

INCOME TAX

REV RUL 2019-23, page 807.

Federal rates; adjusted federal rates; adjusted federal long-term rate, the long-term exempt rate, and the blended annual rate. For purposes of sections 382, 1274, 1288, 7872 and other sections of the Code, tables set forth the rates for October 2019.

TD 9874, page 809.

This Treasury Decision provides guidance regarding the additional first year depreciation deduction under section 168(k) and reflects changes to section 168(k) by the Tax Cuts and Jobs Act.

NOT 2019-52, page 869.

In response to the devastation caused by the 2018 California Wildfires to Butte, Los Angeles, and Ventura counties in the State of California, this notice expands the emergency housing and compliance monitoring relief provided in Rev. Proc. 2014-49, 2014-37 I.R.B. 535, and Rev. Proc. 2014-50, 2014-37 I.R.B. 540. The expanded relief in this notice is limited to the CA Wildfires Major Disaster (as defined in the notice). This notice also solicits public comment regarding any desirable amendments to Rev. Proc. 2014-49 and Rev. Proc. 2014-50.

REG-106808-19, page 912.

These proposed regulations provide guidance regarding the additional first year depreciation deduction under section 168(k), as amended by the Tax Cuts and Jobs Act. This document proposes rules regarding (i) property not eligible for the additional first year depreciation deduction, (ii) a de minimis use rule for determining whether a taxpayer previously used property, (iii) application of the used property acquisition requirements to partnerships, (iv) an election to allow the additional first year depreciation deduction for certain components of larger self-constructed property, (v) computation of the additional first year depreciation deduction for certain property having longer production periods, (vi) the mid-quarter convention, (vii) the definition of binding contract in the context of a business acquisition, and (viii) application of the acquisition requirements to property not acquired pursuant to a written binding contract.

The IRS Mission

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

Introduction

The Internal Revenue Bulletin is the authoritative instrument of the Commissioner of Internal Revenue for announcing official rulings and procedures of the Internal Revenue Service and for publishing Treasury Decisions, Executive Orders, Tax Conventions, legislation, court decisions, and other items of general interest. It is published weekly.

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

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

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

against reaching the same conclusions in other cases unless the facts and circumstances are substantially the same.

The Bulletin is divided into four parts as follows:

Part I.—1986 Code.

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

Part II.—Treaties and Tax Legislation.

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

Part III.—Administrative, Procedural, and Miscellaneous.

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

Part IV.—Items of General Interest.

This part includes notices of proposed rulemakings, disbarment and suspension lists, and announcements.

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

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Part 0

Actions Relating to Decisions of the Tax Court

It is the policy of the Internal Revenue Service to announce at an early date whether it will follow the holdings in certain cases. An Action on Decision is the document making such an announcement. An Action on Decision will be issued at the discretion of the Service only on unappealed issues decided adverse to the government. Generally, an Action on Decision is issued where its guidance would be helpful to Service personnel working with the same or similar issues. Unlike a Treasury Regulation or a Revenue Ruling, an Action on Decision is not an affirmative statement of Service position. It is not intended to serve as public guidance and may not be cited as precedent.

Actions on Decisions shall be relied upon within the Service only as conclusions applying the law to the facts in the particular case at the time the Action on Decision was issued. Caution should be exercised in extending the recommenda-

tion of the Action on Decision to similar cases where the facts are different. Moreover, the recommendation in the Action on Decision may be superseded by new legislation, regulations, rulings, cases, or Actions on Decisions. Prior to 1991, the Service published acquiescence or non-acquiescence only in certain regular Tax Court opinions. The Service has expanded its acquiescence program to include other civil tax cases where guidance is determined to be helpful. Accordingly, the Service now may acquiesce or nonacquiesce in the holdings of memorandum Tax Court opinions, as well as those of the United States District Courts, Claims Court, and Circuit Courts of Appeal. Regardless of the court deciding the case, the recommendation of any Action on Decision will be published in the **Internal Revenue Bulletin**.

The recommendation in every Action on Decision will be summarized as acquiescence, acquiescence in result only, or nonacquiescence. Both “acquiescence” and “acquiescence in result only” mean that the Service accepts the holding of the

court in a case and that the Service will follow it in disposing of cases with the same controlling facts. However, “acquiescence” indicates neither approval nor disapproval of the reasons assigned by the court for its conclusions; whereas, “acquiescence in result only” indicates disagreement or concern with some or all of those reasons. “Nonacquiescence” signifies that, although no further review was sought, the Service does not agree with the holding of the court and, generally, will not follow the decision in disposing of cases involving other taxpayers. In reference to an opinion of a circuit court of appeals, a “nonacquiescence” indicates that the Service will not follow the holding on a nationwide basis. However, the Service will recognize the precedential impact of the opinion on cases arising within the venue of the deciding circuit.

The Commissioner does NOT ACQUIESCE in the following decision:

Union Pacific Railroad Company v. United States,¹

865 F.3d 1045 (8th Cir. 2017), rev'd
No. 8:14CV237 (D. Neb. July 1, 2016)

¹ In *Union Pacific Railroad Company v. United States*, 865 F.3d 1045 (8th Cir. 2017), rev'd No. 8:14CV237 (D. Neb. July 1, 2016), the Eighth Circuit held that lump-sum payments paid to unionized employees upon ratification of collective bargaining agreements (“ratification payments”) are not taxable compensation under the RRTA. In *Union Pacific*, the Eighth Circuit declined to follow *Soc. Sec. Bd. v. Nierotko*, 327 U.S. 358 (1946), and other cases following it that have broadly defined payment for services under FICA. The Supreme Court subsequently rejected the same reasoning in reversing the Eighth Circuit’s opinion in *BNSF Ry. Co. v. Loos*, 139 S.Ct. 893 (2019), and instead emphasized the parallels between the FICA and the RRTA schemes. This AOD provides that *Union Pacific*’s holding on ratification payments has been superseded by the Supreme Court analysis in *Loos*.

Part I

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

(Also Sections 42, 280G, 382, 467, 468, 482, 483, 1288, 7520, 7872.)

Rev. Rul. 2019-23

This revenue ruling provides various prescribed rates for federal income tax purposes for October 2019 (the current month). Table 1 contains the short-term,

mid-term, and long-term applicable federal rates (AFR) for the current month for purposes of section 1274(d) of the Internal Revenue Code. Table 2 contains the short-term, mid-term, and long-term adjusted applicable federal rates (adjusted AFR) for the current month for purposes of section 1288(b). Table 3 sets forth the adjusted federal long-term rate and the long-term tax-exempt rate described in section 382(f). Table 4 contains the appropriate percentages for determining the

low-income housing credit described in section 42(b)(1) for buildings placed in service during the current month. However, under section 42(b)(2), the applicable percentage for non-federally subsidized new buildings placed in service after July 30, 2008, shall not be less than 9%. Finally, Table 5 contains the federal rate for determining the present value of an annuity, an interest for life or for a term of years, or a remainder or a reversionary interest for purposes of section 7520.

REV. RUL. 2019-23 TABLE 1
Applicable Federal Rates (AFR) for October 2019
Period for Compounding

	<i>Annual</i>	<i>Semiannual</i>	<i>Quarterly</i>	<i>Monthly</i>
AFR	1.69%	1.68%	1.68%	1.67%
110% AFR	1.86%	1.85%	1.85%	1.84%
120% AFR	2.03%	2.02%	2.01%	2.01%
130% AFR	2.19%	2.18%	2.17%	2.17%
<i>Mid-term</i>				
AFR	1.51%	1.50%	1.50%	1.50%
110% AFR	1.66%	1.65%	1.65%	1.64%
120% AFR	1.81%	1.80%	1.80%	1.79%
130% AFR	1.96%	1.95%	1.95%	1.94%
150% AFR	2.26%	2.25%	2.24%	2.24%
175% AFR	2.65%	2.63%	2.62%	2.62%
<i>Long-term</i>				
AFR	1.86%	1.85%	1.85%	1.84%
110% AFR	2.05%	2.04%	2.03%	2.03%
120% AFR	2.23%	2.22%	2.21%	2.21%
130% AFR	2.42%	2.41%	2.40%	2.40%

REV. RUL. 2019-23 TABLE 2
Adjusted AFR for October 2019
Period for Compounding

	<i>Annual</i>	<i>Semiannual</i>	<i>Quarterly</i>	<i>Monthly</i>
Short-term adjusted AFR	1.28%	1.28%	1.28%	1.28%
Mid-term adjusted AFR	1.14%	1.14%	1.14%	1.14%
Long-term adjusted AFR	1.40%	1.40%	1.40%	1.40%

REV. RUL. 2019-23 TABLE 3
Rates Under Section 382 for October 2019

Adjusted federal long-term rate for the current month	1.40%
Long-term tax-exempt rate for ownership changes during the current month (the highest of the adjusted federal long-term rates for the current month and the prior two months.)	1.77%

REV. RUL. 2019-23 TABLE 4
Appropriate Percentages Under Section 42(b)(1) for October 2019

Note: Under section 42(b)(2), the applicable percentage for non-federally subsidized new buildings placed in service after July 30, 2008, shall not be less than 9%.	
Appropriate percentage for the 70% present value low-income housing credit	7.39%
Appropriate percentage for the 30% present value low-income housing credit	3.17%

REV. RUL. 2019-23 TABLE 5
Rate Under Section 7520 for October 2019

Applicable federal rate for determining the present value of an annuity, an interest for life or a term of years, or a remainder or reversionary interest	1.8%
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Section 42.—Low-Income Housing Credit

The applicable federal short-term, mid-term, and long-term rates are set forth for the month of October 2019. See Rev. Rul. 2019-23, page 807.

Section 280G.—Golden Parachute Payments

The applicable federal short-term, mid-term, and long-term rates are set forth for the month of October 2019. See Rev. Rul. 2019-23, page 807.

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

The adjusted applicable federal long-term rate is set forth for the month of October 2019. See Rev. Rul. 2019-23, page 807.

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

The applicable federal short-term, mid-term, and long-term rates are set forth for the month of October 2019. See Rev. Rul. 2019-23, page 807.

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

The applicable federal short-term, mid-term, and long-term rates are set forth for the month of October 2019. See Rev. Rul. 2019-23, page 807.

Section 482.—Allocation of Income and Deductions Among Taxpayers

The applicable federal short-term, mid-term, and long-term rates are set forth for the month of October 2019. See Rev. Rul. 2019-23, page 807.

Section 483.—Interest on Certain Deferred Payments

The applicable federal short-term, mid-term, and long-term rates are set forth for the month of October 2019. See Rev. Rul. 2019-23, page 807.

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

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of October 2019. See Rev. Rul. 2019-23, page 807.

Section 7520.—Valuation Tables

The applicable federal short-term, mid-term, and long-term rates are set forth for the month of October 2019. See Rev. Rul. 2019-23, page 807.

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

The applicable federal short-term, mid-term, and long-term rates are set forth for the month of October 2019. See Rev. Rul. 2019-23, page 807.

T.D. 9874**DEPARTMENT OF THE TREASURY****Internal Revenue Service****26 CFR Part 1****Additional First Year Depreciation Deduction**

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations.

SUMMARY: This document contains final regulations that provide guidance regarding the additional first year depreciation deduction under section 168(k) of the Internal Revenue Code (Code). The final regulations reflect and clarify the increase of the benefit and expansion of the universe of qualifying property, particularly to certain classes of used property, authorized by the Tax Cuts and Jobs Act. The final regulations affect taxpayers who deduct depreciation for qualified property acquired and placed in service after September 27, 2017.

DATES: *Effective date:* These regulations are effective on September 24, 2019.

Applicability date: For dates of applicability, see §§1.48-12(a)(2)(i), 1.167(a)-14(e)(3), 1.168(b)-1(b)(2), 1.168(d)-1(d)(2), 1.168(i)-4(g)(2), 1.168(i)-6(k)(4), 1.168(k)-2(h), 1.169-3(g), 1.179-6, 1.312-15(e), 1.704-1(b)(1)(ii)(a), 1.704-3(f), and 1.743-1(l). A taxpayer may choose to apply these final regulations, in their entirety, to qualified property acquired and placed in service or planted or grafted, as applicable, after September 27, 2017, by the taxpayer during taxable years ending on or after September 28, 2017, provided the taxpayer consistently applies all rules in these final regulations. Additionally, a taxpayer may rely on the proposed regulations under section 168(k) in regulation project REG-

104397-18 (2018-41 I.R.B. 558), for qualified property acquired and placed in service or planted or grafted, as applicable, after September 27, 2017, by the taxpayer during taxable years ending on or after September 28, 2017, and ending before September 24, 2019.

FOR FURTHER INFORMATION CONTACT: Elizabeth R. Binder or Kathleen Reed at (202) 317-7005 (not a toll-free number).

SUPPLEMENTARY INFORMATION:**Background**

This document contains amendments to the Income Tax Regulations (26 CFR part 1) under section 168(k). On August 8, 2018, the Department of the Treasury (Treasury Department) and the IRS published a notice of proposed rulemaking (REG-104397-18) in the **Federal Register** (83 FR 39292) containing proposed regulations under section 168(k) (the August Proposed Regulations). The Summary of Comments and Explanation of Revisions section summarizes the provisions of section 168(k) and the provisions of the August Proposed Regulations, which are explained in greater detail in the preamble to the August Proposed Regulations.

The Treasury Department and the IRS received written and electronic comments responding to the August Proposed Regulations and held a public hearing on the proposed regulations on November 28, 2018. After full consideration of the comments received on the August Proposed Regulations and the testimony heard at the public hearing, this Treasury decision adopts the August Proposed Regulations with modifications in response to certain comments and testimony, as described in the Summary of Comments and Explanation of Revisions section. Concurrently with the publication of these final regulations, the Treasury Department and the IRS are publishing in the Proposed Rule section of this edition of the **Federal Register** a notice of proposed rulemaking providing, also in response to the above-cited comments and testimony, additional proposed regulations under section 168(k) (REG-106808-19).

Summary of Comments and Explanation of Revisions

The Treasury Department and the IRS received comments from approximately 20 commenters in response to the August Proposed Regulations. All comments were considered and are available at <https://www.regulations.gov> or upon request. The comments addressing the August Proposed Regulations are summarized in this Summary of Comments and Explanation of Revisions section.

Section 168(k) was amended on December 22, 2017, by sections 12001(b) (13), 13201, and 13204 of the Tax Cuts and Jobs Act, Public Law 115-97 (131 Stat. 2054) (the “Act”). Because of these amendments, the August Proposed Regulations and these final regulations update existing regulations in §1.168(k)-1 by providing a new section at §1.168(k)-2 for property acquired and placed in service after September 27, 2017, and make conforming amendments to the existing regulations.

As discussed in the preamble to the August Proposed Regulations, the August Proposed Regulations and these final regulations describe and clarify the statutory requirements that must be met for depreciable property to qualify for the additional first year depreciation deduction provided by section 168(k). Further, the August Proposed Regulations and these final regulations provide guidance to taxpayers in determining the additional first year depreciation deduction and the amount of depreciation otherwise allowable for this property.

Part I of this section provides an overview of section 168(k). Part II of this section addresses the operational rules. Part III of this section addresses the computation of the additional first year depreciation deduction and the elections under section 168(k). Part IV addresses the special rules for certain situations described in §1.168(k)-2(g) of the final regulations (§1.168(k)-2(f) of the August Proposed Regulations).

I. Overview

Section 167(a) allows as a depreciation deduction a reasonable allowance for the exhaustion, wear and tear, and obsoles-

cence of property used in a trade or business or of property held for the production of income. The depreciation deduction allowable for tangible depreciable property placed in service after 1986 generally is determined under the Modified Accelerated Cost Recovery System provided by section 168 (MACRS property). The depreciation deduction allowable for computer software that is placed in service after August 10, 1993, and is not an amortizable section 197 intangible, is determined under section 167(f)(1).

Section 168(k) was added to the Code by section 101 of the Job Creation and Worker Assistance Act of 2002, Public Law 107-147 (116 Stat. 21). Section 168(k) allows an additional first year depreciation deduction in the placed-in-service year of qualified property. Subsequent amendments to section 168(k) increased the percentage of the additional first year depreciation deduction from 30 percent to 50 percent (to 100 percent for property acquired and placed in service after September 8, 2010, and generally before January 1, 2012), extended the placed-in-service date generally through December 31, 2019, and made other changes.

Section 168(k), prior to amendment by the Act, allowed an additional first year depreciation deduction for the placed-in-service year equal to 50 percent of the adjusted basis of qualified property. Qualified property was defined in part as property the original use of which begins with the taxpayer; that is, the property had to be new property.

Section 13201 of the Act made several amendments to the allowance for additional first year depreciation deduction in section 168(k). For example, the additional first year depreciation deduction percentage is increased from 50 to 100 percent. In addition, the property eligible for the additional first year depreciation deduction is expanded to include certain used depreciable property and certain film, television, or live theatrical productions. Also, the placed-in-service date is extended from before January 1, 2020, to before January 1, 2027 (from before January 1, 2021, to before January 1, 2028, for longer production period property or certain aircraft property described in section 168(k)(2)(B) or (C)). A final example of the amendments by the Act to section

168(k) is the date on which a specified plant is planted or grafted by the taxpayer is extended from before January 1, 2020, to before January 1, 2027.

Section 168(k), as amended by the Act, allows a 100-percent additional first year depreciation deduction for qualified property acquired and placed in service after September 27, 2017, and placed in service before January 1, 2023 (before January 1, 2024, for longer production period property or certain aircraft property described in section 168(k)(2)(B) or (C)). If a taxpayer elects to apply section 168(k)(5), the 100-percent additional first year depreciation deduction also is allowed for a specified plant planted or grafted after September 27, 2017, and before January 1, 2023. The 100-percent additional first year depreciation deduction is decreased by 20 percentage points annually for qualified property placed in service, or a specified plant planted or grafted, after December 31, 2022 (after December 31, 2023, for longer production period property or certain aircraft property described in section 168(k)(2)(B) or (C)).

Section 168(k)(2)(A), as amended by the Act, defines "qualified property" as meaning, in general, property (1) to which section 168 applies that has a recovery period of 20 years or less, (2) which is computer software as defined in section 167(f)(1)(B), for which a deduction is allowable under section 167(a) without regard to section 168(k), (3) which is water utility property, (4) which is a qualified film or television production as defined in section 181(d), for which a deduction would have been allowable under section 181 without regard to section 181(a)(2) or (g) or section 168(k), or (5) which is a qualified live theatrical production as defined in section 181(e), for which a deduction would have been allowable under section 181 without regard to section 181(a)(2) or (g) or section 168(k). "Qualified property" also is defined in section 168(k)(2)(A) as meaning property, the original use of which begins with the taxpayer or the acquisition of which by the taxpayer meets the requirements of section 168(k)(2)(E)(ii); and which is placed in service by the taxpayer before January 1, 2027. Section 168(k)(2)(E)(ii) requires that the acquired property was not used by the taxpayer at any time prior to such acquisition and the

acquisition of such property meets the requirements of section 179(d)(2)(A), (B), and (C) and section 179(d)(3).

However, section 168(k)(2)(D) provides that qualified property does not include any property to which the alternative depreciation system specified in section 168(g) applies, determined without regard to section 168(g)(7) (relating to election to have the alternative depreciation system apply), and after application of section 280F(b) (relating to listed property with limited business use).

Section 13201(h) of the Act provides the effective dates of the amendments to section 168(k) made by section 13201 of the Act. Except as provided in section 13201(h)(2) of the Act, section 13201(h)(1) of the Act provides that these amendments apply to property acquired and placed in service after September 27, 2017. However, property is not treated as acquired after the date on which a written binding contract, as defined in §1.168(k)-2(b)(5)(iii) of these final regulations, is entered into for such acquisition. Section 13201(h)(2) provides that the amendments apply to specified plants planted or grafted after September 27, 2017.

Additionally, section 12001(b)(13) of the Act repealed section 168(k)(4) (relating to the election to accelerate alternative minimum tax credits in lieu of the additional first year depreciation deduction) for taxable years beginning after December 31, 2017. Further, section 13204(a)(4)(B)(ii) repealed section 168(k)(3) (relating to qualified improvement property) for property placed in service after December 31, 2017.

Unless otherwise indicated, all references to section 168(k) hereinafter are references to section 168(k) as amended by the Act.

II. Operational Rules

A. Eligibility Requirements for Additional First Year Depreciation Deduction

The August Proposed Regulations and these final regulations follow section 168(k)(2) and section 13201(h) of the Act to provide that depreciable property must meet four requirements to be qualified property. These requirements are (1) the

depreciable property must be of a specified type; (2) the original use of the depreciable property must commence with the taxpayer or used depreciable property must meet the acquisition requirements of section 168(k)(2)(E)(ii); (3) the depreciable property must be placed in service by the taxpayer within a specified time period or must be planted or grafted by the taxpayer before a specified date; and (4) the depreciable property must be acquired by the taxpayer after September 27, 2017. The written and electronic comments that the Treasury Department and the IRS received with respect to each of these requirements are discussed below.

B. Property of a Specified Type

1. Property Eligible for the Additional First Year Depreciation Deduction

a. In General

The August Proposed Regulations and these final regulations follow the definition of qualified property in section 168(k)(2)(A)(i) and (k)(5) and provide that qualified property must be one of the following: (1) MACRS property that has a recovery period of 20 years or less; (2) computer software as defined in, and depreciated under, section 167(f)(1); (3) water utility property as defined in section 168(e)(5) and depreciated under section 168; (4) a qualified film or television production as defined in section 181(d) and for which a deduction would have been allowable under section 181 without regard to section 181(a)(2) and (g) or section 168(k); (5) a qualified live theatrical production as defined in section 181(e) and for which a deduction would have been allowable under section 181 without regard to section 181(a)(2) and (g) or section 168(k); or (6) a specified plant as defined in section 168(k)(5)(B) and for which the taxpayer has made an election to apply section 168(k)(5).

b. Qualified Improvement Property

The August Proposed Regulations and these final regulations provide that qualified property also includes qualified improvement property that is acquired by the taxpayer after September 27, 2017,

and placed in service by the taxpayer after September 27, 2017, and before January 1, 2018. Multiple commenters requested clarification that qualified improvement property placed in service after 2017 also is qualified property eligible for the additional first year depreciation deduction. Another commenter requested that the IRS not challenge or audit taxpayers that treat qualified improvement property placed in service after 2017 as 15-year property eligible for the additional first year depreciation deduction.

For property placed in service after December 31, 2017, section 13204 of the Act amended section 168(k) to eliminate qualified improvement property as a specific category of qualified property, and amended section 168(e) to eliminate the 15-year MACRS property classification for qualified leasehold improvement property, qualified restaurant property, and qualified retail improvement property. The legislative history of section 13204 of the Act provides that the MACRS recovery period is 15 years for qualified improvement property. Conf. Rep. No. 115-466, at 367 (2017). However, section 168(e), as amended by section 13204 of the Act, does not classify qualified improvement property as having a recovery period of 20 years or less. Consequently, a legislative change must be enacted to provide for a recovery period of 20 years or less for qualified improvement property placed in service after 2017 to be qualified property. Accordingly, the Treasury Department and the IRS decline to adopt these comments.

c. Qualified Restaurant Property and Qualified Retail Improvement Property

The August Proposed Regulations and these final regulations provide that MACRS property with a recovery period of 20 years or less includes the following MACRS property that is acquired by the taxpayer after September 27, 2017, and placed in service by the taxpayer after September 27, 2017, and before January 1, 2018: (1) Qualified leasehold improvement property; (2) qualified restaurant property that is qualified improvement property; and (3) qualified retail improvement property. One commenter requested clarification that qualified retail improve-

ment property, and qualified restaurant property that is qualified improvement property, also are qualified property eligible for the additional first year depreciation deduction. In making this request, the Treasury Department and the IRS assume the commenter is concerned about such property that is placed in service after 2017.

For property placed in service after December 31, 2017, section 13204 of the Act amended section 168(e) to eliminate the 15-year MACRS property classifications for qualified leasehold improvement property, qualified restaurant property, and qualified retail improvement property. Because these property classifications are no longer in effect for property placed in service after 2017, the Treasury Department and the IRS decline to adopt this comment.

d. Qualified Film, Television, or Live Theatrical Production

Consistent with section 168(k)(2)(A)(i) (IV) and (V), the August Proposed Regulations provide that qualified property includes a qualified film or television production, or a qualified live theatrical production, for which a deduction would have been allowable under section 181 without regard to section 181(a)(2) and (g), or section 168(k). One commenter requested guidance on when a qualified film had to be produced by an unrelated party so that a taxpayer acquiring the film now can claim additional first year depreciation. In making this request, the Treasury Department and the IRS assume the commenter interpreted the rule as allowing the additional first year depreciation deduction for a used film production. Another commenter requested clarification on whether a used film or television production qualifies for the additional first year depreciation deduction. These requests involve the interaction of sections 168(k) and 181.

Section 181 allows a taxpayer to elect to deduct up to \$15 million of the aggregate production costs of a qualified film, television, or live theatrical production for the taxable year in which the costs are paid or incurred by the taxpayer instead of capitalizing the costs and recovering such costs through depreciation deductions. See § 1.181-1(a)(1). Pursuant to

§1.181-1(a)(3), production costs do not include the cost of obtaining a production after its initial release or broadcast. Further, §1.181-1(a)(1) provides that only an owner of the qualified film or television production is eligible to make a section 181 election. Section 1.181-1(a)(2)(i) defines an owner, for purposes of §§1.181-1 through -6, as any person that is required under section 263A to capitalize the costs of producing the production into the cost basis of the production, or that would be required to do so if section 263A applied to that person. Pursuant to §1.181-1(a)(2)(ii), a person that acquires a finished or partially-finished production is treated as an owner of that production for purposes §§1.181-1 through -6, but only if the production is acquired prior to its initial release or broadcast. Section 1.181-1(a)(7) defines initial release or broadcast, for purposes of §§1.181-1 through 1.181-6, as the first commercial exhibition or broadcast of a production to an audience.

The Treasury Department and the IRS agree that clarification is needed on whether section 168(k) applies to a used qualified film, television, or live theatrical production. The deduction which would have been allowable under section 181 and §§1.181-1 through 1.181-6 for a qualified film, television, or live theatrical production is only for production costs paid or incurred by an owner of the qualified film or television production prior to its initial release or broadcast or by an owner of the qualified live theatrical production prior to its initial live staged performance. Accordingly, section 168(k) does not apply to a used qualified film, television, or live theatrical production (that is, such production acquired after its initial release or broadcast, or after its initial live staged performance, as applicable). However, the final regulations clarify that only production costs of the qualified film, television, or live theatrical production for which a deduction would have been allowable under section 181 and the regulations under section 181 are eligible for the additional first year depreciation deduction. The final regulations also clarify that the owner, as defined in §1.181-1(a)(2), of the qualified film, television, or live theatrical production is the only taxpayer eligible to claim the additional first year depreciation for

such production and must be the taxpayer that places such production in service.

A commenter requested clarification that a licensee may deduct the additional first year depreciation for the cost of acquiring a license to a qualified film (for example, the cost of acquiring a license of video on demand rights for a limited term or the cost of acquiring a license of rights in a foreign country for a limited term). As stated in the preceding paragraphs, only the owner of the qualified film, television, or live theatrical production is eligible to make a section 181 election. Section 1.181-1(a)(2)(ii) provides that a person that acquires only a limited license or right to exploit a production is not an owner of a production for purposes of §§1.181-1 through 1.181-6. Therefore, for the reasons stated above, the Treasury Department and the IRS decline to adopt this comment.

One commenter suggested that the final regulations clarify when a qualified film, television, or live theatrical production had to be produced to be eligible for the additional first year depreciation deduction. Section 181 is effective for a qualified film or television production commencing after October 22, 2004, and for a qualified live theatrical production commencing after December 31, 2015. Because this suggestion concerns the effective dates of section 181, the suggestion is beyond the scope of these final regulations. Accordingly, the Treasury Department and the IRS decline to adopt this suggestion.

2. Property Not Eligible for the Additional First Year Depreciation Deduction

a. In General

The August Proposed Regulations and these final regulations provide that qualified property does not include (1) property excluded from the application of section 168 as a result of section 168(f); (2) property that is required to be depreciated under the alternative depreciation system of section 168(g) (ADS); (3) any class of property for which the taxpayer elects not to deduct the additional first year depreciation under section 168(k)(7); (4) a specified plant placed in service by the taxpay-

er in the taxable year and for which the taxpayer made an election to apply section 168(k)(5) for a prior year under section 168(k)(5)(D); (5) any class of property for which the taxpayer elects to apply section 168(k)(4), as in effect before the enactment of the Act, to property placed in service in any taxable year beginning before January 1, 2018; or (6) property described in section 168(k)(9)(A) or (B).

b. Property Required to Be Depreciated Under the ADS

Property described in section 168(g)(1)(A), (B), (C), (D), (F), or (G) is required to be depreciated under the ADS. In addition, other provisions of the Code require property to be depreciated under the ADS. 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), and property described in section 280F(b)(1) is required to be depreciated under the ADS.

The Treasury Department and the IRS are aware that taxpayers and practitioners have questioned whether using the ADS to determine the adjusted basis of the taxpayer's qualified business asset investment pursuant to section 250(b)(2)(B) or 951A(d)(3) causes the taxpayer's tangible property to be ineligible for the additional first year depreciation deduction. The final regulations clarify that it does not make that property ineligible for the additional first year depreciation deduction. The final regulations also clarify that using the ADS to determine the adjusted basis of the taxpayer's tangible assets for allocating business interest expense between excepted and non-excepted trades or businesses under section 163(j) does not make that property ineligible for the additional first year depreciation deduction. In both instances, however, this rule does not apply if the property is required to be depreciated under the ADS pursuant to section 168(g)(1)(A), (B), (C), (D), (F), or (G), or other provisions of the Code other than section 163(j), 250(b)(2)(B), or 951A(d)(3).

If section 168(h)(6) applies (property owned by partnerships treated as tax-exempt use property), the Treasury Department and the IRS also are aware that taxpayers and practitioners have questioned

whether only the tax-exempt entity's proportionate share of the property or the entire property is not eligible for the additional first year depreciation deduction. If section 168(h)(6) applies, section 168(h)(6)(A) provides that the tax-exempt entity's proportionate share of the property is treated as tax-exempt use property. Accordingly, the final regulations clarify that only the tax-exempt entity's proportionate share of the property is described in section 168(g)(1)(B) and is not eligible for the additional first year depreciation deduction.

c. Property Described in Section 168(k)(9)

i. In General

Consistent with section 168(k)(9)(A), the August Proposed Regulations and these final regulations provide that qualified property does not include any property that is primarily used in a trade or business described in section 163(j)(7)(A)(iv). Further, consistent with section 168(k)(9)(B), the August Proposed Regulations and these final regulations provide that qualified property does not include any property used in a trade or business that has had floor plan financing indebtedness if the floor plan financing interest related to such indebtedness is taken into account under section 168(j)(1)(C). Because section 163(j) applies to taxable years beginning after December 31, 2017, the August Proposed Regulations and these final regulations also provide that these exclusions from the additional first year depreciation deduction apply to property placed in service in any taxable year beginning after December 31, 2017. The August Proposed Regulations did not provide any further guidance under section 168(k)(9).

Several commenters requested guidance on whether a taxpayer that leases property to a trade or business described in section 168(k)(9) is eligible to claim the additional first year depreciation for the property. Concurrently with the publication of these final regulations, the Treasury Department and the IRS are publishing elsewhere in this issue of the **Federal Register** proposed regulations under section 168(k) (REG-106808-19) that address these comments.

ii. Property Described in Section 168(k)(9)(A) (Regulated Public Utility Property)

The Treasury Department and the IRS are aware that taxpayers and practitioners have questioned how to determine whether property is primarily used in a trade or business described in section 168(k)(9)(A). Concurrently with the publication of these final regulations, the Treasury Department and the IRS are publishing elsewhere in this issue of the **Federal Register** proposed regulations under section 168(k) (REG-106808-19) that address this question.

Several commenters requested guidance on whether property acquired before September 28, 2017, by a trade or business described in section 168(k)(9)(A) is eligible for the additional first year depreciation deduction provided by section 168(k) as in effect before the enactment of the Act. This comment is related to the comment discussed in part II(D)(3) of this Summary of Comments and Explanation of Revisions section regarding the election provided in section 3.02(2)(b) of Rev. Proc. 2011-26 (2011-16 I.R.B. 664). Concurrently with the publication of these final regulations, the Treasury Department and the IRS are publishing elsewhere in this issue of the **Federal Register** proposed regulations under section 168(k) (REG-106808-19) that address both comments.

Another commenter requested that the Treasury Department and the IRS change the position in the August Proposed Regulations so that qualified property does not include property that is primarily used in a trade business described in section 168(k)(9)(A), acquired after September 27, 2017, and placed in service before January 1, 2018. The commenter asserted that the definition of a trade or business in section 163(j)(7)(A)(iv) is not new, and regulated public utility companies were not expecting such property to be eligible for the additional first year depreciation deduction. The definition of a trade or business under section 163(j)(7)(A)(iv) is outside the scope of these final regulations. Further, because section 163(j) applies to taxable years beginning after December 31, 2017, the Treasury Department and the IRS believe that the exclusion of proper-

ty described in section 168(k)(9)(A) from the additional first year depreciation deduction applies to such property placed in service in taxable years beginning after December 31, 2017. Accordingly, the Treasury Department and the IRS decline to adopt this suggestion.

iii. Property Described in Section 168(k)(9)(B) (Floor Plan Financing Indebtedness)

A commenter requested guidance on when floor plan financing interest is "taken into account" for purposes of section 168(k)(9)(B). If section 168(k)(9)(B) applies for a taxable year, the Treasury Department and the IRS also are aware that taxpayers and practitioners have questioned whether "has had floor plan financing indebtedness" in section 168(k)(9)(B) means that the additional first year depreciation deduction is not allowed for property placed in service by a trade or business described in section 168(k)(9)(B) in any subsequent taxable year. Concurrently with the publication of these final regulations, the Treasury Department and the IRS are publishing elsewhere in this issue of the **Federal Register** proposed regulations under section 168(k) (REG-106808-19) that address both matters.

C. New and Used Property

1. New Property

The August Proposed Regulations and these final regulations generally retain the original use rules in §1.168(k)-1(b)(3). Pursuant to section 168(k)(2)(A)(ii), the August Proposed Regulations and these final regulations do not provide any date by which the original use of the property must commence with the taxpayer.

The August Proposed Regulations and these final regulations define original use as meaning the first use to which the property is put, whether or not that use corresponds to the use of the property by the taxpayer. A commenter requested that this definition be revised to provide that original use means the first use of the property within the United States. The definition of original use in the August Proposed Regulations and in §1.168(k)-1(b)(3) is the same as the definition of such term

in the legislative history of the Job Creation and Worker Assistance Act of 2002, Public Law 107-147 (116 Stat. 21), that added section 168(k) to the Code. There is no indication in the legislative history of section 13201 of the Act that Congress intended to change the definition of original use. Accordingly, the Treasury Department and the IRS decline to adopt this comment.

2. Used Property

a. In General

Pursuant to section 168(k)(2)(A)(ii) and (k)(2)(E)(ii), the August Proposed Regulations and these final regulations provide that the acquisition of used property is eligible for the additional first year depreciation deduction if such acquisition meets the following three requirements: (1) The property was not used by the taxpayer or a predecessor at any time prior to the acquisition; (2) the acquisition of the property meets the related party and carry-over basis requirements of section 179(d)(2)(A), (B), and (C) and §1.179-4(c)(1)(ii), (iii), and (iv), or §1.179-4(c)(2); and (3) the acquisition of the property meets the cost requirements of section 179(d)(3) and §1.179-4(d).

Several commenters requested a definition of “predecessor.” One commenter suggested that the term be limited to a transfer described in section 381. Another commenter suggested that the term be comprehensively defined, including transactions between partners and partnerships, or shareholders and corporations. This commenter also asserted that restrictions based on use by a predecessor should be removed because the language is not in section 168(k).

Besides the used property requirements in the August Proposed Regulations, the term “predecessor” is used in the acquisition requirements in the proposed regulations and in §1.168(k)-1(b)(4). The Treasury Department and the IRS have determined that the inclusion of predecessor in both requirements is necessary and appropriate to prevent abuse by taxpayers to churn assets. Accordingly, the Treasury Department and the IRS do not adopt the suggestion to remove the term “predecessor.”

However, the Treasury Department and the IRS agree that a definition of predecessor is needed. The final regulations provide that a predecessor includes (i) a transferor of an asset to a transferee in a transaction to which section 381(a) applies, (ii) a transferor of an asset to a transferee in a transaction in which the transferee’s basis in the asset is determined, in whole or in part, by reference to the basis of the asset in the hands of the transferor, (iii) a partnership that is considered as continuing under section 708(b)(2), (iv) the decedent in the case of an asset acquired by an estate, or (v) a transferor of an asset to a trust.

b. Depreciable Interest

The August Proposed Regulations and these final regulations provide that the property is treated as used by the taxpayer or a predecessor at any time prior to acquisition by the taxpayer or predecessor if the taxpayer or the predecessor had a depreciable interest in the property at any time prior to such acquisition, whether or not the taxpayer or the predecessor claimed depreciation deductions for the property.

i. Definition

A commenter requested a definition of “depreciable interest” or a clarification that the term has the meaning as applied for purposes of section 167. The term “depreciable interest” in the August Proposed Regulations and these final regulations has the same meaning as that term is used for purposes of section 167. The property must be used in the taxpayer’s trade or business or held by the taxpayer for the production of income pursuant to section 167(a). In addition, case law provides that the person who made the capital investment in the property is the person entitled to a return on that capital by means of claiming a depreciation deduction. *Gladding Dry Goods Co. v. Commissioner*, 2 B.T.A. 336, 338 (1925). Legal title and the right of possession are not determinative. *Hopkins Partners v. Commissioner*, T.C. Memo. 2009-107 (citing *Gladding Dry Goods*, 2 B.T.A. at 338). Instead, the question is which party actually invested in the property. Id.

The issue of whether a taxpayer has a depreciable interest in property generally arises when a lessor or a lessee makes improvements to property. If a lessor makes improvements at the lessor’s own expense, the lessor is entitled to depreciation deductions even though the lessee has the use of the improvements. *Gladding Dry Goods*, 2 B.T.A. at 338-339; *Hopkins Partners*. If a lessee makes improvements and the title to the improvements vests immediately in the lessor, the lessor’s bare legal title does not preclude the lessee from recovering its investment in the improvements through depreciation deductions. *Hopkins Partners*; see also *McGrath v. Commissioner*, T.C. Memo. 2002-231. However, when the lessee makes improvements as a substitute for rent, the lessee has no depreciable interest in the leasehold improvement. *Hopkins Partners* (citing *Your Health Club, Inc. v. Commissioner*, 4 T.C. 385, 390 (1944), acq., 1945 C.B. 7). Because the determination of whether a person has a depreciable interest in the property depends on the facts and circumstances and concerns whether the property is eligible for the depreciation deduction under section 167, the request is beyond the scope of these final regulations. Accordingly, the Treasury Department and the IRS decline to adopt this comment.

ii. Safe Harbor

The preamble to the August Proposed Regulations requested comments on whether a safe harbor should be provided on how many taxable years a taxpayer or a predecessor should look back to determine if the taxpayer or the predecessor previously had a depreciable interest in the property. Multiple commenters made suggestions. One commenter suggested a look-back period of five years from the placed-in-service date of the property, with a rebuttable presumption that neither the taxpayer nor a predecessor held a depreciable interest in the property prior to the 5-year period. Other commenters suggested a look-back period of three years, including the current taxable year. Another commenter suggested that the prior use rule apply only to property initially owned on or after the date of enactment of the Act and a look-back period that is the shorter of the applicable recovery pe-

riod of the property or 10 years. Another commenter suggested no look-back period for used property to be used in the United States for the first time. Finally, another commenter suggested the following three alternatives for determining if property is previously used by the taxpayer or a predecessor: the prior use or disposition of the property occurred pursuant to a plan that included the taxpayer's reacquisition of the property; the person possesses actual or constructive knowledge of the prior use of the property; or provide a look-back period measured by reference to the property's recovery period, such as the lesser of the property's recovery period or a set number of years.

After considering these suggestions, the Treasury Department and the IRS have decided to provide a look-back period of five calendar years immediately prior to the taxpayer's current placed-in-service year of the property. We believe that five years is the appropriate number of years to reduce the potential for churning assets. Most assets have a recovery period of five or seven years under section 168(c). In addition, we believe that this bright-line test will be easy for both taxpayers and the IRS to administer. Therefore, the final regulations provide that to determine if the taxpayer or a predecessor had a depreciable interest in the property at any time prior to acquisition, only the five calendar years immediately prior to the taxpayer's current placed-in-service year of the property are taken into account. If the taxpayer and a predecessor have not been in existence for this entire 5-year period, only the number of calendar years the taxpayer and the predecessor have been in existence is taken into account.

iii. Used in the United States for the First Time

A commenter requested the August Proposed Regulations be revised to allow the used property requirements be met for property that will be used in the United States for the first time and that is acquired at its fair market value by a U.S. taxpayer from a non-U.S. related party, and for property that is acquired by a U.S. affiliate from a non-U.S. parent corporation in an arm's-length transaction. The statutory language of section 168(k)(2)(E)(ii) and

the legislative history of section 13201 of the Act do not support such a rule. Conf. Rep. No. 115-466, at 353. Accordingly, the Treasury Department and the IRS decline to adopt this comment.

iv. Substantial Renovation of Property

The Treasury Department and the IRS are aware that taxpayers and practitioners have questioned whether a taxpayer that purchases substantially renovated property is eligible to claim the additional first year depreciation deduction for such property (assuming all other requirements are met).

The August Proposed Regulations and these final regulations retain the original use rules in §1.168(k)-1(b)(3)(i). Under these rules, the cost of reconditioned or rebuilt property does not satisfy the original use requirement. However, if the cost of the used parts in such property is not more than 20 percent of the total cost of the property, whether acquired or self-constructed, the property is treated as meeting the original use requirement.

Consistent with the original use rules, the final regulations provide that if a taxpayer acquires and places in service substantially renovated property and the taxpayer or a predecessor previously had a depreciable interest in the property before it was substantially renovated, that taxpayer's or predecessor's depreciable interest is not taken into account for determining whether the substantially renovated property was used by the taxpayer or a predecessor at any time before its acquisition by the taxpayer. For this purpose and consistent with the original use rules, property is substantially renovated if the cost of the used parts is not more than 20 percent of the total cost of the substantially renovated property, whether acquired or self-constructed.

c. Section 336(e) Election

Section 1.179-4(c)(2) provides that property deemed to have been acquired by a new target corporation as a result of a section 338 election will be considered acquired by purchase for purposes of §1.179-4(c)(1). Upon a section 338 election, the target corporation (old target) is treated as transferring all of its assets to

an unrelated person in exchange for consideration that includes the discharge of its liabilities, and a different corporation (new target) is treated as acquiring all of its assets from an unrelated person in exchange for consideration that includes the assumption of those liabilities. Section 1.338-1(a)(1). Although both old target and new target are a single corporation under corporate law, §1.338-1(a)(1) provides that they generally are considered to exist as separate corporations for purposes of subtitle A of the Code.

The Federal income tax consequences of a section 336(e) election made with respect to a qualified stock disposition not described, in whole or in part, in section 355(d)(2) or (e)(2) are similar to the Federal income tax consequences of a section 338 election. See §1.336-2(b)(1). Accordingly, the August Proposed Regulations and these final regulations modify §1.179-4(c)(2) to include property deemed to have been acquired by a new target corporation pursuant to a section 336(e) election made with respect to such a qualified stock disposition. Thus, property deemed to have been acquired by a new target corporation as a result of either a section 338 election or a section 336(e) election made with respect to a qualified stock disposition not described, in whole or in part, in section 355(d)(2) or (e)(2) is considered acquired by purchase for purposes of §1.179-4(c)(1).

Conversely, if a section 336(e) election is made with respect to a qualified stock disposition that is described, in whole or in part, in section 355(d)(2) or (e)(2), old target is treated as selling its assets to an unrelated person but then purchasing the assets back (sale-to-self model). Section 1.336-2(b)(2). Because the sale-to-self model does not deem a new target corporation to acquire the assets from an unrelated person, commenters have questioned whether assets deemed purchased in such a qualified stock disposition should be considered acquired by purchase for purposes of §1.179-4(c)(1). The final regulations clarify that the reference to section 336(e) in §1.179-4(c)(2) does not include dispositions described in section 355(d)(2) or (e)(2) because, under the sale-to-self model, old target will be treated as acquiring the assets in which it previously had a depreciable interest.

d. Rules Applying to Consolidated Groups

The August Proposed Regulations treat a member of a consolidated group as previously having a depreciable interest in all property in which the consolidated group is treated as previously having a depreciable interest. For purposes of this proposed rule, a consolidated group is treated as having a depreciable interest in property if any current or previous member of the group had a depreciable interest in the property while a member of the group. The August Proposed Regulations also do not allow the additional first year depreciation deduction when, as part of a series of related transactions, one or more members of a consolidated group acquire both the stock of a corporation that previously had a depreciable interest in the property and the property itself. Additionally, if the acquisition of property is part of a series of related transactions that also includes one or more transactions in which the transferee of the property ceases to be a member of a consolidated group, then whether the taxpayer is a member of a consolidated group is tested immediately after the last transaction in the series.

Multiple commenters requested clarification of these rules. Concurrently with the publication of the final regulations, the Treasury Department and the IRS are publishing elsewhere in this issue of the **Federal Register** proposed regulations under section 168(k) (REG-106808-19) that address these comments.

e. Series of Related Transactions

Section 1.168(k)-2(b)(3)(iii)(C) of the August Proposed Regulations provides that, in the case of a series of related transactions, property is treated as directly transferred from the original transferor to the ultimate transferee, and the relation between the original transferor and the ultimate transferee is tested immediately after the last transaction in the series (related transactions rule). We received comments requesting clarification on the application of the related transactions rule in certain circumstances. Concurrently with the publication of the final regulations, the Treasury Department and the IRS are publishing elsewhere in this issue of the

Federal Register proposed regulations under section 168(k) (REG-106808-19) that address these comments.

f. Application to Partnerships

The August Proposed Regulations and these final regulations address whether certain section 704(c) allocations, the basis of distributed property determined under section 732, and basis adjustments under sections 734(b) and 743(b) qualify for the additional first year depreciation deduction. One commenter recommended applying the principles underlying section 197(f)(9) to analyze these issues under section 168(k). The Treasury Department and the IRS considered this approach and determined that it was not appropriate for purposes of section 168(k). Although the regulations under section 197(f)(9) apply an aggregate approach with respect to basis adjustments under sections 732, 734, and 743 (as well as certain section 704(c) allocations), the Treasury Department and the IRS looked to the purpose of section 168(k), not section 197(f)(9), to determine how to best approach the entity versus aggregate theory question. Furthermore, the statutory language found in section 197(f)(9)(E), which treats each partner in a partnership as having owned and used the partner's proportionate share of the partnership's assets for purposes of determining basis increases under sections 732, 734, and 743, is not in section 168(k). Therefore, the August Proposed Regulations and these final regulations determine the proper treatment of each basis adjustment under section 168(k) on a case-by-case basis.

One commenter to the August Proposed Regulations asked for clarification regarding a partner's depreciable interest in property held by a partnership. Concurrently with the publication of the final regulations, the Treasury Department and the IRS are publishing elsewhere in this issue of the **Federal Register** proposed regulations under section 168(k) (REG-106808-19) that address this comment.

i. Section 704(c) Remedial Allocations

The August Proposed Regulations and these final regulations provide that remedial allocations under section 704(c) do

not qualify for the additional first year depreciation deduction. The same rule applies in the case of revaluations of partnership property (reverse section 704(c) allocations).

One commenter requested that the final regulations permit immediate expensing of excess book basis under the remedial allocation method in §1.704-3(d) and corresponding remedial allocations of income and depreciation. The Treasury Department and the IRS decline to adopt this comment because the underlying property that gives rise to remedial allocations was contributed to the partnership in a section 721 transaction and has a basis described in section 179(d)(2)(C), which is in violation of section 168(k)(2)(E)(ii)(I), as well as the original use requirement.

ii. Section 734(b) Adjustments

The August Proposed Regulations and these final regulations provide that section 734(b) basis adjustments are not eligible for the additional first year depreciation deduction.

One commenter suggested that the Treasury Department and the IRS should permit immediate expensing of basis adjustments under section 734(b)(1)(A) allocable to qualified property. Section 734(b)(1)(A) provides that, in the case of a distribution of property to a partner with respect to which a section 754 election is in effect (or when there is a substantial basis reduction under section 734(d)), the partnership will increase the adjusted basis of partnership property by the amount of any gain recognized to the distributee partner under section 731(a)(1). The Treasury Department and the IRS decline to adopt this comment because section 734(b) adjustments are made to the common basis of partnership property and do not satisfy the original use clause of section 168(k)(2)(A)(ii) or the used property requirement of section 168(k)(2)(E)(ii)(I).

iii. Section 743(b) Adjustments

The August Proposed Regulations and these final regulations provide that, in determining whether a section 743(b) basis adjustment meets the used property acquisition requirements of section 168(k)(2)(E)(ii), each partner is treated as having

owned and used the partner's proportionate share of partnership property. In the case of a transfer of a partnership interest, section 168(k)(2)(E)(ii)(I) will be satisfied if the partner acquiring the interest, or a predecessor of such partner, has not used the portion of the partnership property to which the section 743(b) basis adjustment relates at any time prior to the acquisition (that is, the transferee has not used the transferor's portion of partnership property prior to the acquisition), notwithstanding the fact that the partnership itself has previously used the property. Similarly, for purposes of applying section 179(d)(2)(A), (B), and (C), the partner acquiring a partnership interest is treated as acquiring a portion of partnership property, and the partner who is transferring a partnership interest is treated as the person from whom the property is acquired.

The August Proposed Regulations provide that a section 743(b) basis adjustment in a class of property (not including the property class for section 743(b) basis adjustments) may be recovered using the additional first year depreciation deduction under section 168(k) without regard to whether the partnership elects out of the additional first year depreciation deduction under section 168(k)(7) for all other qualified property in the same class of property and placed in service in the same taxable year. Similarly, a partnership may make the election out of the additional first year depreciation deduction under section 168(k)(7) for a section 743(b) basis adjustment in a class of property (not including the property class for section 743(b) basis adjustments), and this election will not bind the partnership to such election for all other qualified property of the partnership in the same class of property and placed in service in the same taxable year.

One commenter recommended that the final regulations require consistent treatment for section 743(b) adjustments in a class of property and all other qualified property in the same class and placed in service in the same taxable year. The Treasury Department and the IRS believe that taxpayers should have the flexibility to use or elect out of the additional first year depreciation deduction for section 743(b) adjustments in a class of property without being bound to that choice for all other qualified property in the same class and

placed in service in the same taxable year. Therefore, the final regulations retain the rule of the August Proposed Regulations.

One commenter requested that upper-tier partnerships be able to make an election under section 168(k)(7), or not, for both qualified property held directly by the upper-tier partnership and qualified property held indirectly through lower-tier partnerships. The Treasury Department and the IRS believe that a system of upper-tier partnerships making this election on behalf of lower-tier partnerships would be difficult to administer, and decline to adopt this comment. Lower-tier partnerships can make a section 168(k)(7) separately or may choose not to make that election.

One commenter suggested that there could be potential confusion with the language that would be added to §1.743-1(j)(4)(i)(B)(1) by the August Proposed Regulations. This commenter stated that the addition of "notwithstanding the above" to that provision could be read to negate other provisions of §1.743-1(j)(4)(i)(B). The Treasury Department and the IRS did not intend this implication. In these final regulations, the Treasury Department and the IRS have clarified this section by removing "notwithstanding the above."

The preamble to the August Proposed Regulations provides that a section 743(b) basis adjustment is eligible for the additional first year depreciation deduction provided all of the requirements of section 168(k) are met and assuming §1.743-1(j)(4)(i)(B)(2) does not apply. Some commenters asked for clarification regarding the application of §1.743-1(j)(4)(i)(B)(2). Section 1.743-1(j)(4)(i)(B)(2) provides that, if a partnership uses the remedial allocation method under §1.704-3(d) with respect to an item of the partnership's recovery property, then the portion of any section 743(b) basis increase for that property that is attributable to section 704(c) built-in gain is recovered over the remaining recovery period for the 's excess book basis in the as determined in the final sentence of §1.704-3(d)(2). This would preclude the partner from taking the additional first year depreciation deduction for the portion of the section 743(b) basis increase attributable to section 704(c) built-in gain. Section 1.743-1(j)(4)(i)(B)(2) further provides that any remaining

portion of a section 743(b) basis increase is recovered under §1.743-1(j)(4)(i)(B)(1), which treats a section 743(b) basis increase as newly-purchased property placed in service when the transfer of the partnership interest occurs. Section 1.743-1(j)(4)(i)(B)(1) also provides that any applicable recovery period and method may be used for the basis increase. Therefore, under the August Proposed Regulations, the additional first year depreciation deduction is available for the portion of a section 743(b) basis increase that is not attributable to section 704(c) built-in gain, regardless of the section 704(c) method used, assuming all the requirements of section 168(k) are satisfied.

One commenter requested that the final regulations permit a partnership to use the additional first year depreciation deduction with respect to the portion of the section 743(b) basis increase that is attributable to section 704(c) built-in gain, even if the partnership is using the remedial allocation method with respect to the property. The Treasury Department and the IRS agree with this comment. However, an exception to this rule is needed in the case of publicly traded partnerships (within the meaning of section 7704(b)) to maintain fungibility for publicly traded partnership units. Thus, the final regulations amend §1.743-1(j)(4)(i)(B)(2) to provide an exception to the rule that the portion of a section 743(b) basis increase that is attributable to section 704(c) built-in gain is recovered over the remaining recovery period for the 's excess book basis in the . This exception applies only in the case of a partnership that is not a publicly traded partnership and that is recovering a section 743(b) basis increase using the additional first year depreciation deduction under section 168(k). If this exception applies, the entire section 743(b) basis increase is eligible for the additional first year depreciation. For publicly traded partnerships, the rules of the August Proposed Regulations described in the preceding paragraph continue to apply.

g. Syndication Transaction

The syndication transaction rule in the August Proposed Regulations and these final regulations is based on the rules in

section 168(k)(2)(E)(iii) for syndication transactions.

For new or used property, the August Proposed Regulations provide that if (1) a lessor has a depreciable interest in the property and the lessor and any predecessor did not previously have a depreciable interest in the property, (2) the property 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 (3) the user (lessee) 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, then the purchaser of the property in the last sale during the three-month period is considered the taxpayer that acquired the property, has a depreciable interest in the property, and the taxpayer that originally placed the property in service, but not earlier than the date of the last sale. Thus, if a transaction is within the rules described above, the purchaser of the property in the last sale during the three-month period is eligible to claim the additional first year depreciation for the property assuming all requirements are met, and the earlier purchasers of the property are not.

If the lessor reacquires the property, a commenter requested that the August Proposed Regulations be clarified to provide that the lessor did not previously have a depreciable interest in the property. The Treasury Department and the IRS agree with this suggestion. Accordingly, the final regulations clarify that, if a transaction is within the rules described in the preceding paragraph, the purchaser of the property in the last sale during the three-month period is the original user of the property, if the lessor acquired and placed in service new property, and is the taxpayer having a depreciable interest in the property, if the lessor acquired and placed in service used property. Neither the lessor nor any intermediate purchaser is treated as previously having a depreciable interest in the property.

h. Sale-leaseback Transaction

Because section 13201 of the Act removed the rules regarding sale-leasebacks, the August Proposed Regulations did not retain the original use rules in §1.168(k)-1(b)(3)(iii)(A) and (C) regarding such transactions, including a sale-leaseback transaction followed by a syndication transaction. A commenter requested that the depreciable interest rule in the August Proposed Regulations be changed to a never-have-depreciated test so that a seller-lessee in a sale-leaseback transaction that exercises the option to purchase the property at the end of the lease term will meet the used property rules in the proposed regulations. Alternatively, the commenter suggested §1.168(k)-2(f)(1) of the August Proposed Regulations be revised to allow the additional first year depreciation deduction in the situation described in the preceding sentence provided the sale-leaseback occurred in the same taxable year in which the seller-lessee placed the property in service. The commenter asserted that leased assets should not be treated differently than other used property. Another commenter asserted that a rule similar to the one in §1.168(k)-1(b)(3)(iii)(A) should be provided when the sale-leaseback occurs within a very short period of time after the property is placed in service by the seller-lessee.

The Treasury Department and the IRS have decided not to adopt these comments, because section 13201 of the Act removed the rules regarding sale-leasebacks. However, the Treasury Department and the IRS believe that an exception to the depreciable interest rule is appropriate when the taxpayer disposes of property within a short period of time after the taxpayer placed such property in service. Concurrently with the publication of these final regulations, the Treasury Department and the IRS are publishing elsewhere in this issue of the **Federal Register** proposed regulations under section 168(k) (REG-106808-19) that provide this proposed rule.

D. Date of Acquisition

1. In General

The August Proposed Regulations and these final regulations provide rules appli-

cable to the acquisition requirements of the effective date under section 13201(h) of the Act. The August Proposed Regulations and these final regulations provide that these rules apply to all property, including self-constructed property or property described in section 168(k)(2)(B) or (C).

Pursuant to section 13201(h)(1)(A) of the Act, the August Proposed Regulations and these final regulations provide that the property must be acquired by the taxpayer after September 27, 2017, or, acquired by the taxpayer pursuant to a written binding contract entered into by the taxpayer after September 27, 2017.

The August Proposed Regulations also provide that property that is manufactured, constructed, or produced for the taxpayer by another person under a written binding contract 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 acquired pursuant to a written binding contract. Many commenters disagreed with this position because it is not supported by the legislative history of section 13201 of the Act, it is a departure from the self-constructed property rules in §1.168(k)-1(b)(4)(iii), and it is administratively burdensome. The Treasury Department and the IRS have reconsidered their decision. Accordingly, §1.168(k)-2(b)(5)(ii)(A) and (b)(5)(iv) of the final regulations provide that property that is manufactured, constructed, or produced for the taxpayer by another person under a written binding contract 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 not acquired pursuant to a written binding contract but is self-constructed property.

The August Proposed Regulations also provide that if the written binding contract states the date on which the contract was entered into and a closing date, delivery date, or other similar date, the date on which the contract was entered into is the date the taxpayer acquired the property. The Treasury Department and the IRS are aware that some contracts are not binding contracts on the date the contract is entered into (for example, due to a contingency clause). Accordingly, §1.168(k)-

2(b)(5)(ii)(B) of the final regulations provides that the acquisition date of property that the taxpayer acquired pursuant to a written binding contract is the later of (1) the date on which the contract was entered into; (2) the date on which the contract is enforceable under State law; (3) if the contract has one or more cancellation periods, the date on which all cancellation periods end; or (4) if the contract has one or more contingency clauses, the date on which all conditions subject to such clauses are satisfied. For this purpose, a cancellation period is the number of days stated in the contract for any party to cancel the contract without penalty, and a contingency clause is one that provides for a condition (or conditions) or action (or actions) that is within the control of any party or a predecessor.

2. Written Binding Contract

A commenter requested clarification on whether the liquidated damages rule in §1.168(k)-2(b)(5)(iii)(A) in the August Proposed Regulations applies only to a breach by the purchaser. A similar question was raised in comments on §1.168(k)-1T regarding the rule stating that 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. At that time, the Treasury Department and the IRS decided that the limitations should fall on both parties, the purchaser and the seller. The same should apply in the instant case. Accordingly, the Treasury Department and the IRS decline to adopt this comment.

The Treasury Department and the IRS are aware that taxpayers and practitioners have questioned how to apply the 5-percent liquidated damages rule in the August Proposed Regulations when the contract has multiple damage provisions. The Treasury Department and the IRS intended that only the provision with the highest damages be taken into account in determining whether the contract limits damages. The final regulations clarify this intention.

Another commenter requested clarification on whether any of the costs of property acquired before September 28, 2017, pursuant to a written binding con-

tract, and placed in service after 2017 are eligible for the additional first year depreciation deduction under section 168(k). If some, but not all, of the costs are eligible, or if the costs are subject to the different applicable percentages, the commenter also requested that a basis allocation rule be provided. This comment is related to the comment discussed in part II(D)(3) of this Summary of Comments and Explanation of Revisions section regarding the election provided in section 3.02(2)(b) of Rev. Proc. 2011-26 (2011-16 I.R.B. 664). Concurrently with the publication of these final regulations, the Treasury Department and the IRS are publishing elsewhere in this issue of the **Federal Register** proposed regulations under section 168(k) (REG-106808-19) that address these comments.

The Treasury Department and the IRS are aware that taxpayers and practitioners are having difficulty applying the binding contract rules in the August Proposed Regulations to transactions involving the acquisition of an entity. Because those rules were written to apply to the purchase of an asset instead of an entity, the Treasury Department and the IRS recognize that a binding contract rule for an acquisition of a trade or business, or an entity, is needed. The Treasury Department and the IRS also are aware that, in some cases, a taxpayer did not acquire property pursuant to a written binding contract. Concurrently with the publication of these final regulations, the Treasury Department and the IRS are publishing elsewhere in this issue of the **Federal Register** proposed regulations under section 168(k) (REG-106808-19) that address these issues.

3. Self-Constructed Property

If a taxpayer manufactures, constructs, or produces property for its own use, the Treasury Department and the IRS recognize that the written binding contract rule in section 13201(h)(1) of the Act does not apply. In such case, the August Proposed Regulations and these final regulations provide that the acquisition rules in section 13201(h)(1) of the Act are treated as met if the taxpayer begins manufacturing, constructing, or producing the property after September 27, 2017. As stated in part II(D)(1) of this Summary of Comments

and Explanation of Revisions section, the final regulations provide that property that is manufactured, constructed, or produced for the taxpayer by another person under a written binding contract that is entered into prior to the manufacture, construction, or production of the property is self-constructed property by the taxpayer. In this case, these final regulations also provide that the acquisition rules in section 13201(h)(1) of the Act are treated as met if the taxpayer begins manufacturing, constructing, or producing such property after September 27, 2017. The August Proposed Regulations and these final regulations provide rules similar to those in §1.168(k)-1(b)(4)(iii)(B) for defining when manufacturing, construction, or production begins, including the safe harbor, and in §1.168(k)-1(b)(4)(iii)(C) for a contract to acquire, or for the manufacture, construction, or production of, a component of the larger self-constructed property.

Two commenters requested clarification on whether the cost of a component of a larger self-constructed property that is acquired under a binding contract entered into before September 28, 2017, is included in the safe harbor for determining when manufacturing, construction, or production of the larger self-constructed property begins. Consistent with §1.168(k)-1(b)(4)(iii)(B)(2), the safe harbor in the August Proposed Regulations and these final regulations do not provide a date restriction for calculation of the 10 percent. Accordingly, examples in §1.168(k)-2(d)(3)(iv), which has the same safe harbor as in §1.168(k)-2(b)(5)(iv), illustrate that the cost of such component is taken into account for determining whether the taxpayer has paid or incurred 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) under the safe harbor. If the cost of the acquired component is 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), the manufacture, construction, or production of the larger self-constructed property begins on the date on which the taxpayer paid or incurred the cost of such component.

A commenter requested clarification on whether the 100-percent additional first year depreciation deduction is allowable for self-constructed property owned by a trade or business described in section 163(j)(7)(A)(iv) (regulated public utility) where the construction of such property begins after September 27, 2017, and the property is placed in service in a taxable year beginning after 2017. In such case, the property is not eligible for the 100-percent additional first year depreciation deduction pursuant to section 168(k)(9)(A). *Example 11* is provided in §1.168(k)-2(b)(5)(viii)(K) of these final regulations to illustrate this point.

Multiple commenters requested that the final regulations provide an election similar to the one provided in section 3.02(2)(b) of Rev. Proc. 2011-26 for components acquired or self-constructed after September 27, 2017, of larger self-constructed property when the manufacture, construction, or production of the larger self-constructed property begins before September 28, 2017. Concurrently with the publication of these final regulations, the Treasury Department and the IRS are publishing elsewhere in this issue of the **Federal Register** proposed regulations under section 168(k) (REG-106808-19) that address these comments.

III. Computation of Additional First Year Depreciation Deduction and Elections Under Section 168(k)

A. Computation of Additional First Year Depreciation Deduction

Pursuant to section 168(k)(1)(A), the August Proposed Regulations and these final regulations provide that the allowable additional first year depreciation deduction for qualified property is equal to the applicable percentage (as defined in section 168(k)(6)) of the unadjusted depreciable basis (as defined in §1.168(b)-1(a)(3)) of the property. For qualified property described in section 168(k)(2)(B), the unadjusted depreciable basis (as defined in §1.168(b)-1(a)(3)) of the property is limited to the property's basis attributable to manufacture, construction, or production of the property before January 1, 2027, as provided in section 168(k)(2)(B)(ii). Pursuant to section 168(k)(2)(G), the Au-

gust Proposed Regulations and these final regulations also provide that the additional first year depreciation deduction is allowed for both regular tax and alternative minimum tax (AMT) purposes. The August Proposed Regulations and these final regulations provide rules similar to those in §1.168(k)-1(d)(2) for determining the amount of depreciation otherwise allowable for qualified property.

A commenter requested clarification on whether the deduction under section 181 for a qualified film, television, or live theatrical production is taken before the additional first year depreciation deduction for the same production. Section 181(b) provides that with respect to the basis of any qualified film or television production or any qualified live theatrical production to which an election under section 181(a) is made, no other depreciation or amortization deduction shall be allowable. Consequently, if the owner of the qualified film, television, or live theatrical production makes an election under section 181(a), the basis of the production is reduced by the amount of the section 181 deduction before the additional first year depreciation deduction is computed. Accordingly, the final regulations revise the definition of unadjusted depreciable basis in §1.168(b)-1(a)(3) to reflect the reduction in basis for the amount the taxpayer elects to treat as an expense under section 181.

B. Elections Under Section 168(k)

The August Proposed Regulations and these final regulations provide rules for making the election out of the additional first year depreciation deduction pursuant to section 168(k)(7) and for making the election to apply section 168(k)(5) to a specified plant. Additionally, the August Proposed Regulations and these final regulations provide rules for making the election under section 168(k)(10) to deduct 50 percent, instead of 100 percent, additional first year depreciation for qualified property acquired after September 27, 2017, by the taxpayer and placed in service or planted or grafted, as applicable, by the taxpayer during its taxable year that includes September 28, 2017.

Several commenters requested relief to make late elections under section 168(k)(7) or (10) for property placed in service

during the taxpayer's taxable year that includes September 28, 2017, because some taxpayers already filed their Federal tax returns for that taxable year before the proposed regulations were issued. The commenters also noted that a taxpayer with a due date, with extensions, of September 15, 2018, or October 15, 2018, for its Federal tax return for the taxable year that includes September 28, 2017, may not have had sufficient time to analyze the proposed regulations to make a timely election under section 168(k)(7) or (10). The IRS issued Revenue Procedure 2019-33 (2019-34 I.R.B. 662) to address this request by providing an additional period of time for taxpayers to make an election, or revoke an election, under section 168(k)(5), (7), or (10) for property acquired after September 27, 2017, and placed in service during the taxpayer's taxable year that includes September 28, 2017.

IV. Special Rules

The August Proposed Regulations and these final regulations provide special rules similar to those in §1.168(k)-1(f) for the following situations: (1) Qualified property placed in service or planted or grafted, as applicable, and disposed of in the same taxable year; (2) redetermination of basis of qualified property; (3) recapture of additional first year depreciation for purposes of section 1245 and section 1250; (4) a certified pollution control facility that is qualified property; (5) like-kind exchanges and involuntary conversions of qualified property; (6) a change in use of qualified property; (7) the computation of earnings and profits; (8) the increase in the limitation of the amount of depreciation for passenger automobiles; (9) the rehabilitation credit under section 47; and (10) computation of depreciation for purposes of section 514(a)(3).

The August Proposed Regulations and these final regulations provide a special rule for qualified property that is placed in service in a taxable year and then contributed to a partnership under section 721(a) in the same taxable year when one of the other partners previously had a depreciable interest in the property. Situation 1 of Rev. Rul. 99-5 (1999-1 C.B. 434) is an example of such a fact pattern. In this situation, the August Proposed Regulations

provide that the additional first year depreciation deduction with respect to the contributed property is not allocated under the general rules of §1.168(d)-1(b)(7)(ii). Instead, the additional first year depreciation deduction is allocated entirely to the contributing partner prior to the section 721(a) transaction and not to the partnership.

In the fact pattern described in the preceding paragraph, a commenter requested clarification on whether the property is placed in service by the contributing partner prior to the section 721(a) transaction. Another commenter requested clarification on whether the contributing partner deducts the additional first year depreciation for the qualified property or the partnership allocates the additional first year depreciation deduction for the qualified property to the contributing partner. The final regulations provide that the contributing partner is deemed to place in service the qualified property prior to the section 721(a) transaction, and that the contributing partner deducts the entire additional first year depreciation for such property. The contributing partner will contribute the property to the partnership with a zero basis, and the contributed property will be section 704(c) property in the hands of the partnership.

Several commenters questioned how the August Proposed Regulations apply to a section 743(b) adjustment when there is a purchase of a partnership interest followed by a subsequent transfer of that partnership interest. Under the August Proposed Regulations, if qualified property is placed into service or planted or grafted, as applicable, and disposed of in the same taxable year, the additional first year depreciation deduction generally is not allowed. However, there is an exception to this rule in the case of nonrecognition transfers under section 168(i)(7). These rules in the August Proposed Regulations apply only to transfers of qualified property and not to section 743(b) adjustments resulting from transfers of partnership interests. Several commenters recommended that parallel rules should apply to transfers of partnership interests. The Treasury Department and the IRS agree with this comment.

These final regulations provide that, if a partnership interest is acquired and disposed of during the same taxable year, the

additional first year depreciation deduction is not allowed for any section 743(b) adjustment arising from the initial acquisition. However, if a partnership interest is purchased and disposed of in a section 168(i)(7) transaction in the same taxable year, the section 743(b) adjustment is allowable, provided all of the requirements of section 168(k) are satisfied. The section 743(b) adjustment is apportioned between the purchaser/transferor and the transferee under the same rules that apply to transfers of qualified property.

A commenter requested a rule allowing dealerships that purchase replacement vehicles for use in their fleet of rental or leased vehicles to deduct the additional first year depreciation deduction in transactions that are similar to like-kind exchanges when at least 10 vehicles are traded in during the same taxable year. The treatment requested is similar to that given to like-kind exchanges under section 1031 as in effect before the enactment of the Act. The Treasury Department and the IRS decline to adopt this comment because it is outside the scope of these final regulations.

The Treasury Department and the IRS are aware that taxpayers and practitioners have questioned whether the unadjusted basis of qualified property for which the additional first year depreciation deduction is claimed is taken into account in determining whether the mid-quarter convention under section 168(d) and §1.168(d)-1 applies for the taxable year. Consistent with the definition of depreciable basis in §1.168(d)-1(b)(4), the basis is not reduced by the allowed or allowable additional first year depreciation deduction in determining whether the mid-quarter convention applies for the taxable year. Concurrently with the publication of these final regulations, the Treasury Department and the IRS are publishing elsewhere in this issue of the **Federal Register** proposed regulations under section 168(k) (REG-106808-19) that provide this proposed rule.

Statement of Availability of IRS Documents

The IRS Revenue Procedures and Revenue Rulings cited in this document are published in the Internal Revenue Bulletin

(or Cumulative Bulletin) and are available from the Superintendent of Documents, U.S. Government Publishing Office, Washington, DC 20402, or by visiting the IRS website at <http://www.irs.gov>.

Effective/Applicability Date

These final regulations apply to qualified property placed in service or planted or grafted, as applicable, by the taxpayer during or after the taxpayer's taxable year that includes September 24, 2019. However, a taxpayer may choose to apply these final regulations, in their entirety, to qualified property acquired and placed in service or planted or grafted, as applicable, after September 27, 2017, by the taxpayer during taxable years ending on or after September 28, 2017, provided the taxpayer consistently applies all rules in these final regulations. Additionally, a taxpayer may rely on the proposed regulations under section 168(k) in regulation project REG-104397-18 (2018-41 I.R.B. 558), to qualified property acquired and placed in service or planted or grafted, as applicable, after September 27, 2017, by the taxpayer during taxable years ending on or after September 28, 2017, and ending before September 24, 2019.

Special Analyses

I. Regulatory Planning and Review – Economic Analysis

Executive Orders 12866 and 13563 direct agencies to assess costs and benefits of available regulatory alternatives and, if regulation is necessary, to select regulatory approaches that maximize net benefits (including (i) potential economic, environmental, and public health and safety effects, (ii) potential distributive impacts, and (iii) equity). Executive Order 13563 emphasizes the importance of quantifying both costs and benefits, reducing costs, harmonizing rules, and promoting flexibility.

These regulations have been designated as subject to review under Executive Order 12866 pursuant to the Memorandum of Agreement (April 11, 2018) (MOA) between the Treasury Department and the Office of Management and Budget (OMB) regarding review of tax regulations. The Office of Information and Reg-

ulatory Affairs has designated these regulations as economically significant under section 1(c) of the MOA. Accordingly, the OMB has reviewed these regulations.

A. Background

1. Bonus Depreciation Generally

In general, section 167 allows taxpayers to claim a “reasonable allowance for the exhaustion, wear and tear” of property used in a trade or business or held for the production of income. For most tangible property, the amount of the deduction is determined under section 168, which ef-

fectively provides schedules of deductions (as a share of the initial basis) for different types of assets. The baseline schedule generally provides for the deduction to be spread over a number of years.

In the Job Creation and Worker Assistance Act of 2002, Congress put in place section 168(k), creating what is colloquially known as “bonus depreciation.” Under this initial legislation, firms were allowed to take a deduction equal to 30 percent of the initial basis of qualified property in the year in which it was placed in service; the remaining 70 percent was depreciated according to the usual schedule. Broadly speaking, “qualified property” included

personal property that had a class life of 20 years or less; additionally, the property was required to be “new,” meaning that the original use of the property must have commenced with the taxpayer in question. By shifting depreciation deductions forward in time, section 168(k) generally increased the present value of the depreciation deductions attributable to a given piece of property, increasing the incentive to invest in new property. Since 2001, Congress has changed the “bonus percentage” several times, in accordance with the following table, including the 2005-2007 period when bonus depreciation was not in effect for most property.

Table 1 Percent additional depreciation (for most qualified property), by date placed in service

Property placed in service:		
Beginning date	End date	Bonus percentage
9/11/2001	5/4/2003	30%
5/5/2003	12/31/2004	50%
1/1/2005	12/31/2007	0%
1/1/2008	9/8/2010	50%
9/9/2010	12/31/2011	100%
1/1/2012	12/31/2017	50%

2. Bonus Depreciation Under the Act

The Act changed section 168(k) in several ways. First, the Act increased the bonus percentage. Under the pre-Act section 168(k), the bonus percentage for most property was 50 percent in 2017, 40 percent in 2018, 30 percent in 2019, and zero thereafter. The Act amended these percentages to 100 percent for most property placed in service between September 28, 2017 and the end of 2022, 80 percent in 2023, 60 percent in 2024, 40 percent in 2025, 20 percent in 2026, and 0 thereafter. The Act also removed the “original use” requirement, meaning that taxpayers could claim bonus depreciation on “used” property.

The Act made several other modest changes to the operation of section 168(k). First, it excluded from the definition of qualified property any property used by rate-regulated utilities and firms (primarily automobile dealerships) with “floor

plan financing indebtedness” as defined under section 163(j). Similarly, section 168(g)(1)(G) provides that certain property used by real property and agricultural businesses that make an election to be excluded from the section 163(j) limitation are required to use the Alternative Depreciation System (ADS) for certain property which does not qualify for bonus depreciation. Furthermore, section 168(k)(2)(a)(ii)(IV) and (V) allowed qualified film, television, and live theatrical productions (as defined under section 181) to qualify for bonus depreciation.

3. Proposed and Final Regulations

The August Proposed Regulations and these final regulations create §1.168(k)-2 which applies generally to property acquired and placed in service after September 27, 2017. The August Proposed Regulations and these final regulations largely draw upon language in existing

§1.168(k)-1, which generally continues to apply to property acquired or placed in service prior to September 27, 2017, with minor edits being made to conform to changes made by the Act. For provisions of section 168 that were generally unchanged by the Act, §1.168(k)-2 predominantly follows §1.168(k)-1 directly, with only minor changes. Additionally, §1.168(k)-2 provides rules that clarify how the changes to section 168 made by the Act apply to property acquired after September 27, 2017.

In some instances the final regulations repeat unambiguous rules provided in the statute. However, there were a number of areas where clarification was necessary, and the analysis below focuses on these substantive portions of the regulation. These final regulations finalize certain provisions of the August Proposed Regulations with no change. In addition, these final regulations include provisions from the August Proposed Regulations that

were modified to take into account comments received. The provisions discussed in this special analysis include (1) rules regarding film, television, and live theatrical performances, (2) clarifications regarding property depreciated under ADS for purposes other than section 168, (3) the eligibility of partnership basis adjustments under section 743(b) for bonus depreciation, (4) the treatment of tax-exempt use property, as defined by section 168(h)(6), (5) the definition of “prior use” for determining whether “used” property is eligible for bonus depreciation, and (6) clarifications regarding the date at which property is considered to be acquired in the case of self-constructed property.

B. No-action Baseline

The Treasury Department and the IRS have assessed the benefits and costs of these final regulations relative to a no-action baseline reflecting anticipated Federal income tax-related behavior in the absence of these final regulations.

C. Economic Analysis of Regulation

This section describes the main provisions of these final regulations, (including those finalized with no change from the August Proposed Regulations) and analyzes the economic effects of each one.

1. Film, Television, and Live Theatrical Performances

Sections 168(k)(2)(A)(i)(IV) and (V) provide that a qualified film or television production, or a qualified live theatrical production, is eligible for bonus depreciation, borrowing definitions from section 181. There was ambiguity in determining whether “used” film, television, and theatrical performances were eligible – i.e., those properties whose production began under a different taxpayer. Following existing rules under section 181, these final regulations provide that direct production costs and acquisition costs are eligible for bonus depreciation in the hands of the owner, so long as the production was acquired before the initial date of release (or initial live staged performance). The Treasury Department and the IRS have determined that this is the proper interpre-

tation of the statute, and that other statutory readings were not legally supportable. Nevertheless, this result provides a middle ground between two extreme positions: one in which only the initial owner was eligible for bonus depreciation, and one in which all acquisition costs of film, television, or live theatrical performances were eligible for section 168(k) under nearly all circumstances. Thus, the incentives for investment – and therefore the potential link to economic growth and efficiency – created by this interpretation are also in the middle of these two extremes. The Treasury Department and IRS expect that most taxpayers would have come to a similar interpretation of the treatment of used television, film, and theatrical performances in the absence of these final regulations. Therefore, the Treasury Department and IRS project that this clarification will have only small economic effects.

Additionally, while section 181 and the regulations thereunder provide a definition for when a film or television production is placed in service, they do not do so for live theatrical performances. The August Proposed Regulations and these final regulations provide such a definition for live theatrical performances, directly adapting the rules for film and television productions to live theatrical performances. Specifically, a live theatrical performance is considered placed in service when it begins commercial exhibition (i.e., performances in front of paying audiences); an exhibition designed to attract further funding, or to determine whether the production should proceed, does not qualify as a commercial exhibition. This rule delays the placed in service date relative to the alternative choice (in which such an earlier exhibition would cause a live theatrical performance to be placed in service). This choice has two potential offsetting economic effects. First, this choice potentially delays the date in which the taxpayer could claim bonus depreciation for the performance, which could slightly reduce the incentive to invest in such a performance. Second, this choice increases the length of time over which a potential buyer could acquire the performance and remain eligible to claim bonus depreciation (since the acquisition of a production is only eligible until the date of its initial live staged performance); this could slightly increase

the incentive to invest in such productions by increasing resale opportunities. The Treasury Department and the IRS project that these offsetting effects will have only small net effects on investment in live theatrical performances.

2. Depreciation Using ADS for Purposes Other than Section 168

In general, property that is required to be depreciated under the ADS is not eligible for bonus depreciation. Additionally, some provisions of the code (such as sections 250(b)(2)(B) and 951A(d)(3)) require the use of ADS to determine aggregate basis for the purpose of that provision (but not for the purpose of calculating depreciation deductions under section 168). These final regulations clarifies that such a requirement does not cause a property to be ineligible for bonus depreciation. The Treasury Department and the IRS project that most taxpayers would have come to this interpretation in the absence of this final regulation, so this provision is likely to have modest economic effects. Nevertheless, this decision might give certainty to a small number of taxpayers that their property is, in fact, eligible for bonus depreciation despite interactions with other Code provisions, potentially creating a small incentive for additional investment.

3. Eligibility of Partnership Basis Adjustments Under Section 743(b)

Under the August Proposed Regulations, basis increases under section 743(b) (which generally occur when partnership interests are transferred) are generally eligible for bonus depreciation. These final regulations generally finalize this rule with only minor clarifications.

The effect of allowing a section 743(b) adjustment to be eligible for bonus depreciation can best be explained by the following example. Suppose taxpayers A and B contribute \$100,000 each in cash to start Partnership X. Partnership X purchases a \$150,000 piece of equipment Y (of a character that is eligible for bonus depreciation) and holds a \$50,000 non-depreciable asset. After some number of years, the basis of Partnership X in Y (that is, the “inside basis” of Y in the hands of

Partnership X) has been adjusted down to 0 through depreciation, but the fair market value (FMV) of Y is \$60,000. Assume no other earnings of the partnership or fluctuations in asset FMV. At this point, total FMV of the assets held by Partnership X are \$110,000, and A and B each have a \$25,000 basis in their interest in Partnership X.

Suppose, at this point, that B sells her interest to C, an unrelated party, for \$55,000 (equal to half of the FMV of the assets held by the partnership). As a result, C has basis of \$55,000 in his interest in Partnership X, and B realizes a gain of \$30,000 (equal to \$55,000 minus her basis of \$25,000). Under the usual rules of partnership taxation, this would cause a disconnect between C's outside basis – that is, the basis of C in Partnership X, which in this case is \$55,000 – and C's inside basis in the assets held by Partnership X, which in this case equals \$25,000. This disconnect can produce undesired results, such as a certain gain being converted from capital to ordinary, or being taxed sooner than economically realized. Therefore, section 754 allows taxpayers to make certain adjustments, if elected. Assuming that a section 754 election is in place for Partnership X, section 743(b) causes the basis of Y to be increased by \$30,000, equal to the gain recognized by B, and this basis adjustment would explicitly be assigned to C (meaning that any future cost recovery, through depreciation or otherwise, would be allocated to C). This causes C's inside basis and outside basis to come back into alignment, at \$55,000 in this example.

Under section 168(k) prior to the Act, such section 743(b) adjustments were determined to be ineligible for bonus depreciation, since the tangible property acquired was, by construction, not "new." Economically, this meant that the transfer of the partnership interest caused an immediate realization of gain by the seller, and a deferred realization of deduction items by the buyer. This created a modest incentive for sellers to hold onto their assets for longer periods of time, in order to defer tax payments. As has been well studied, this incentive can lead to portfolio misallocation, hindering the allocation of capital to its most efficient use. (This problem is often referred to as "lock-in.")

The Treasury Department and the IRS concluded that the Act's allowance of "used" property to qualify for bonus depreciation (subject to the other restrictions discussed in detail in the August Proposed Regulations and these final regulations) should extend to section 743(b) adjustments as well. This has the economic effect of mitigating the lock-in problem for transfers of certain partnership interests with built-in gains (to the extent that the section 743(b) adjustment is attributable to property that is of a character that qualifies for bonus depreciation). In the previous example discussed in this part I(C)(3) of this Special Analysis section, this would have the effect of allowing Partnership X to claim an immediate \$30,000 deduction (which would be allocated to C) for its \$30,000 section 743(b) adjustment. This \$30,000 deduction precisely equals the \$30,000 in gain realized by B. Therefore, the aggregate tax consequences faced by B and C cancel out, eliminating the lock-in effect in this simple example.

Reducing the lock-in effect for transfers of partnership interests can improve the efficiency of capital allocations throughout the economy. The Treasury Department and the IRS engaged in an analysis of the potential increase in output due to this potential increase in allocative efficiency. Based on projections regarding which partnerships will make adjustments under section 743(b) and assumptions about frictions to adjusting the capital stock, the Treasury Department and the IRS have concluded that the total economy-wide gain to output caused by this reduction in lock-in would be less than \$5 million per year.

Relatedly, allowing section 743(b) adjustments to be eligible for bonus depreciation increases the incentive for a new partner to acquire an interest in a partnership from another partner, potentially increasing the value of the partnership slightly. This can have the effect of making a previous investment in tangible property more attractive, which has an effect similar to a small reduction in the cost of capital for such partnerships. Based on an analysis of tax data, and applying estimates of the elasticity of capital with respect to the cost of capital, the Treasury Department and the IRS project that this effect will increase investment by no more

than \$20 million in any year, with smaller effects in most years.

4. Property Owned by Partnerships Treated as Tax-exempt Use Property

Section 168(h)(6) provides that property held by a partnership in which one partner is a tax-exempt entity and another partner is not is "tax-exempt use property." Section 168(g)(1)(B) requires tax-exempt use property to be depreciated according to the ADS, which renders tax-exempt use property ineligible for bonus depreciation. These final regulations clarify that only the tax-exempt entity's proportional share of the property is ineligible for bonus depreciation, which is consistent with other rules in the August Proposed Regulations and these final regulations providing that partners have a depreciable interest in only their proportionate share of assets held by a partnership. Relative to an interpretation defining all property held by such a partnership with a tax-exempt partner to be ineligible, this provision will generally have the effect of increasing the amount of property eligible for bonus depreciation, which will slightly increase the incentive for such partnerships to invest in physical capital.

Based on entities filing Form 990 (for certain tax-exempt entities) and Form 5500 (for certain pension plans), the Treasury Department and the IRS have determined that there were approximately 100,000 partnerships in 2015 (out of nearly 4 million partnerships total) that were owned directly by at least one tax-exempt partner and at least one taxable partner. This figure could potentially be an underestimate, as it will not count partnerships that have a common structure in which the tax-exempt partner owns the partnership through a "blocker" C corporation (which could be treated tax-exempt under the rules of section 168(h)(6)(F)). Furthermore, this estimate does not take account of multi-tiered partnership structures. On the other hand, not all such partnerships would make depreciable investments that are affected by this final regulation.

5. New and Used Property

In order for a property to be eligible for bonus depreciation, it must generally

satisfy one of two conditions: (1) the original use of the property begins with the taxpayer, or (2) “such property was not used by the taxpayer at any time prior to such acquisition” (section 168(k)(2)(E)(ii)(I)). Neither the August Proposed Regulations nor these final regulations make any substantial changes to the “original use” rules in §1.168(k)-1(b)(3). However, clarification was needed regarding the determination of whether “such property was ... used by the taxpayer ... prior to such acquisition”. One common circumstance in which this could be ambiguous is when a lessee uses (but does not own) a piece of property and then purchases that property upon the expiration of the lease. These final regulations follow the intent of Congress (as indicated by the Joint Committee on Taxation, General Explanation of Public Law 115-97 (JCS-1-18) at 125 fn. 542 (Dec. 20, 2018)) to define “used” as meaning that the taxpayer previously held a “depreciable interest” in the property. In general, this would allow the former lessee in such an example to claim bonus depreciation upon the subsequent purchase of the property in question (assuming all other requirements are met).

These final regulations make several additional clarifications regarding what is meant by “prior depreciable interest.” First, these final regulations provide that a taxpayer will be considered to have had a prior depreciable interest in a piece of property if his/her predecessor had such a prior depreciable interest; likewise, these final regulations provide a definition of “predecessor,” as requested by commenters. Second, these final regulations provide a safe harbor look-back period of five calendar years for determining whether a taxpayer had a prior depreciable interest. The Treasury Department and the IRS chose a five-year period because the vast majority of bonus-eligible assets have General Depreciation Schedule (GDS) lives of 5 years or more (3-year property is uncommon), and thus taxpayers will tend to have readily accessible records for these assets.

These rules will help ease administrative and compliance burdens: taxpayers will be able to more clearly identify their predecessors, if any, and the limited look-back period will mitigate the infeasibility of the implicit infinite lookback period

some might interpret as a requirement of the statute. Both of these rules should help provide clarity and help reassure taxpayers that they will not accidentally run afoul of the prior depreciable interest rules, potentially encouraging more firms to take advantage of the investment incentives created by section 168(k).

Third, these final regulations provide that “substantially renovated property” can be eligible for bonus depreciation, even if the taxpayer had a prior depreciable interest in the property prior to the renovation. For this purpose, a property is a “substantially renovated property” if the cost of the used parts is less than or equal to 20 percent of the total cost of the (post-renovation) property, whether acquired or self-constructed. The Treasury Department and the IRS project that this provision will have limited economic effects, as it will come into play only in the relatively rare circumstance in which a taxpayer is purchasing substantially renovated property and held a prior depreciable interest in the pre-renovation property. Nevertheless, this provision will generally increase the amount of property eligible for bonus depreciation, increasing the incentive to invest.

6. Date of Acquisition

The Act provides that property must be acquired by the taxpayer after September 27, 2017, or acquired by the taxpayer pursuant to a “written binding contract” entered into after September 27, 2017, in order for the property to be eligible for the 100 percent bonus depreciation rate. There was some ambiguity regarding whether third-party constructed property – that is, property that is produced for the taxpayer by a third party under a written binding contract – is acquired “pursuant to a written binding contract” or whether it is considered self-constructed property. The August Proposed Regulations reflected the interpretation that third party constructed property is not self-constructed property and the contract for such property must have been entered into after September 27, 2017, in order to be eligible for 100 percent bonus depreciation. However, the final regulations under §1.168(k)-1 took a different interpretation, such that the acquisition date of all self-constructed

property (including third party constructed property) is equal to the (usually later) date when substantial construction begins.

These final regulations provide for the latter interpretation: third-party constructed property is treated as self-constructed property, meaning that more taxpayers will be eligible for 100 percent bonus depreciation for property where contracts were entered into prior to September 27, 2017, but for which substantial construction began after that date. Given that this provision affects only investment that has already been made, the Treasury Department and the IRS expect it to have virtually no effect on economic growth or efficiency going forward, except to the extent that it changes taxpayers’ expectations about future policy.

II. Paperwork Reduction Act

These final regulations do not impose any additional information collection requirements in the form of reporting, recordkeeping requirements, or third-party disclosure requirements. However, taxpayers that want to make or revoke the election under section 168(k)(5), (7), or (10), are required to attach a statement to their Federal tax returns pursuant to the instructions for Form 4562, “Depreciation and Amortization (Including Information on Listed Property)”. Also, pursuant to Rev. Proc. 2019-33 (2019-34 I.R.B. 662), taxpayers may make or revoke the election under section 168(k)(5), (7), or (10) by filing, within a specified time period, amended Federal tax returns, or Form 3115, “Application for Change in Accounting Method,” with their Federal tax returns and submit a copy of the Form 3115 to the IRS office in Ogden, Utah.

For purposes of the Paperwork Reduction Act of 1995 (44 U.S.C. 3507(d)) (PRA), the reporting burden associated with these collections of information will be reflected in the PRA submission associated with income tax returns in the Form 1120 series, Form 1040 series, Form 1041 series, and Form 1065 series (see chart at the end of this part II for OMB control numbers). The estimate for the number of impacted filers with respect to the collection of information described in this part is 0 to 141,550 respondents. Historical data

was not available to directly estimate the number of impacted filers. This estimate assumes that no more than 5 percent of

income tax return filers with a Form 4562 and relevant activity on lines 14 and/or 19(a-f) will make these elections, due to

the limited scope of the elections. The IRS estimates the number of affected filers to be the following:

Tax Forms Impacted		
Collection of information	Number of respondents (estimated)	Forms to which the information may be attached
Section 1.168(k)-2(f)(1) Election not to deduct additional first year depreciation	0-41,685	Form 1120 series, Form 1040 series, Form 1041 series, and Form 1065 series
Section 1.168(k)-2(f)(2) Election to apply section 168(k)(5) for specified plants	0-790	Form 1120 series, Form 1040 series, Form 1041 series, and Form 1065 series
Section 1.168(k)-2(f)(3) Election for qualified property placed in service during the 2017 taxable year	0-90,275	Form 1120 series, Form 1040 series, Form 1041 series, and Form 1065 series
Section 1.168(k)-2(f)(5)(ii) (Revocation of election – Automatic 6-month extension) and §1.168(k)-2(f)(6) (Special rules for 2016 and 2017 returns)	0-8,800	Form 1120 series, Form 1040 series, Form 1041 series, and Form 1065 series

Source: IRS:RAAS:KDA (CDW 6-1-19)

If the time under Rev. Proc. 2019-33 for filing amended returns or Form 3115 has expired to revoke the election under section 168(k)(5), (7), or (10), taxpayers then are required to submit a request for a private letter ruling to revoke such election in accordance with Rev. Proc. 2019-1 (2019-1 I.R.B. 1) (or its successors). For

purposes of the PRA, the reporting burden associated with these collections of information will be reflected in the PRA submission associated with income tax returns in the Form 1120 series and Form 1065 series (see chart at the end of this part II for OMB control numbers). The estimate for the number of impacted filers

with respect to the collection of information described in this part is 0 to 10 respondents. This estimate is based on the number of private letter ruling requests filed by taxpayers from 2005 through 2018 to revoke elections under section 168(k). The IRS estimates the number of affected filers to be the following:

Tax Forms Impacted		
Collection of information	Number of respondents (estimated)	Forms to which the information may be attached
Section 1.168(k)-2(f)(5)(i) Revocation of election	0-10	Form 1120 series and Form 1065 series

Source: IRS:CC:ITA (CASE-MIS 5-21-19)

The current status of the PRA submissions related to the tax forms and the revenue procedure that will be revised as a result of the information collections in these final regulations is provided in the accompanying table. As described above, the reporting burdens associated with the information collections in the regulations are included in the aggregated burden estimates for OMB control numbers 1545-0123 (which represents a total estimated burden time for all forms and schedules for corporations of 3.157 billion hours and total estimated monetized costs of \$58.148 billion (\$2017)), 1545-0074 (which represents a total estimated burden time, including all other related forms and schedules for individuals, of 1.784

billion hours and total estimated monetized costs of \$31.764 billion (\$2017)), and 1545-0092 (which represents a total estimated burden time, including all other related forms and schedules for trusts and estates, of 307,844,800 hours and total estimated monetized costs of \$9.950 billion (\$2016)).

The overall burden estimates provided in the preceding paragraph for the OMB control numbers below are aggregate amounts that relate to the entire package of forms or revenue procedure, as applicable, associated with the applicable OMB control number and will in the future include, but not isolate, the estimated burden of the tax forms or the revenue procedure, as applicable, that will be created or

revised as a result of the information collections in the regulations. These numbers are therefore unrelated to the future calculations needed to assess the burden imposed by the regulations. These burdens have been reported for other regulations that rely on the same OMB control numbers to conduct information collections under the PRA, and the Treasury Department and the IRS urge readers to recognize that these numbers are duplicates and to guard against over counting the burden that the regulations that cite these OMB control numbers imposed prior to the Act. No burden estimates specific to the forms affected by the regulations are currently available. The Treasury Department and the IRS have not estimated the burden,

including that of any new information collections, related to the requirements under the regulations. For the OMB control numbers discussed in the preceding paragraphs, the Treasury Department and the IRS estimate PRA burdens on a taxpayer-type basis rather than a provision-specific basis. Those estimates would capture both changes made by the Act and those that arise out of discretionary authority

exercised in these final regulations and other regulations that affect the compliance burden for those forms.

The Treasury Department and the IRS request comments on all aspects of information collection burdens related to the proposed regulations, including estimates for how much time it would take to comply with the paperwork burdens described above for each relevant form or revenue

procedure, as applicable, and ways for the IRS to minimize the paperwork burden. In addition, when available, drafts of IRS forms are posted for comment at <https://apps.irs.gov/app/picklist/list/draft-TaxForms.htm>. IRS forms are available at <https://www.irs.gov/forms-instructions>. Forms will not be finalized until after they have been approved by OMB under the PRA.

Form	Type of Filer	OMB Number(s)	Status
Form 1040	Individual (NEW Model)	1545-0074	Published in the Federal Register on 7/20/18. Public Comment period closed on 9/18/18. Link: https://www.federalregister.gov/documents/2018/07/20/2018-15627/proposed-collection-comment-request-for-regulation-project
	Trusts and estates	1545-0092	Published in the Federal Register on 4/4/18. Public Comment period closed on 6/4/18. Link: https://www.federalregister.gov/documents/2018/04/04/2018-06892/proposed-collection-comment-request-for-form-1041
Form 1041	Business (NEW Model)	1545-0123	Published in the Federal Register on 10/8/18. Public Comment period closed on 12/10/18. Link: https://www.federalregister.gov/documents/2018/10/09/2018-21846/proposed-collection-comment-request-for-forms-1065-1065-b-1066-1120-1120-c-1120-f-1120-h-1120-nd
	All other Filers (mainly trusts and estates) (Legacy system)	1545-2070	Published in the Federal Register on 2/15/17 by IRS. Public Comment period closed on 4/17/17. Link: https://www.federalregister.gov/documents/2017/02/15/2017-02985/proposed-information-collection-comment-request
Form 3115	Business (NEW Model)	1545-0123	Published in the Federal Register on 10/8/18. Public Comment period closed on 12/10/18. Link: https://www.federalregister.gov/documents/2018/10/09/2018-21846/proposed-collection-comment-request-for-forms-1065-1065-b-1066-1120-1120-c-1120-f-1120-h-1120-nd
	Individual (NEW Model)	1545-0074	Published in the Federal Register on 7/20/18. Public Comment period closed on 9/18/18. Link: https://www.federalregister.gov/documents/2018/07/20/2018-15627/proposed-collection-comment-request-for-regulation-project
	Business (NEW Model)	1545-0123	Published in the Federal Register on 10/8/18. Public Comment period closed on 12/10/18. Link: https://www.federalregister.gov/documents/2018/10/09/2018-21846/proposed-collection-comment-request-for-forms-1065-1065-b-1066-1120-1120-c-1120-f-1120-h-1120-nd
Revenue Procedure 2019-1 (previously 2018-1)	Business (NEW Model)	1545-0123	Published in the Federal Register on 10/8/18. Public Comment period closed on 12/10/18. Link: https://www.federalregister.gov/documents/2018/10/09/2018-21846/proposed-collection-comment-request-for-forms-1065-1065-b-1066-1120-1120-c-1120-f-1120-h-1120-nd

III. Regulatory Flexibility Act

It is hereby certified that these final regulations will not have a significant economic impact on a substantial number of

small entities within the meaning of section 601(6) of the Regulatory Flexibility Act (5 U.S.C. chapter 6).

Section 168(k) generally affects taxpayers that own and use depreciable

property in their trades or businesses or for their production of income. The reporting burdens in §1.168(k)-2(f)(1), (2), and (3), (f)(5)(i) and (ii), and (f)(6) generally affect taxpayers that elect

to make or revoke certain elections under section 168(k). For purposes of the PRA, the Treasury Department and the IRS estimate that there are 0 to 141,550 respondents of all sizes that are likely to

be impacted by these collections of information. Most of these filers are likely to be small entities (business entities with gross receipts of \$25 million or less pursuant to section 448(c)(1)). The Treas-

sury Department and the IRS estimate the number of filers affected by §1.168(k)-2(f)(1), (2), and (3), (f)(5)(i) and (ii), and (f)(6) to be the following:

Form	Gross receipts of \$25 million or less	Gross receipts over \$25 million
Form 1040	0-59,000 Respondents (estimated)	0-70 Respondents (estimated)
Form 1065	0-30,125 Respondents (estimated)	0-935 Respondents (estimated)
Form 1120	0-11,400 Respondents (estimated)	0-1,560 Respondents (estimated)
Form 1120S	0-35,900 Respondents (estimated)	0-2,560 Respondents (estimated)
TOTAL	0-136,425 Respondents (estimated)	0-5,125 Respondents (estimated)

Source: IRS:RAAS:KDA (CDW 6-1-19)

Regardless of the number of small entities potentially affected by these final regulations, the Treasury Department and the IRS have concluded that §1.168(k)-2(f)(1), (2), and (3), (f)(5)(i) and (ii), and (f)(6) will not have a significant economic impact on a substantial number of small entities. This conclusion is based on the fact that: (1) Many small businesses are not required to capitalize under section 263(a) the amount paid or incurred for the acquisition of depreciable tangible property that costs \$5,000 or less if the business has an applicable financial statement or costs \$500 or less if the business does not have an applicable financial statement, pursuant to §1.263(a)-1(f)(1); (2) many small businesses are no longer required to capitalize under section 263A the costs to construct, build, manufacture, install, improve, raise, or grow depreciable property if their average annual gross receipts are \$25,000,000 or less; and (3) a small business that capitalizes costs of depreciable tangible property may deduct under section 179 up to \$1,020,000 (2019 inflation adjusted amount) of the cost of such property placed in service during the taxable year if the total cost of depreciable tangible property placed in service during the taxable year does not exceed \$2,550,000 (2019 inflation adjusted amount). Further, §1.168(k)-2(f)(1), (2), and (3), (f)(5)(i) and

(ii), and (f)(6) apply only if the taxpayer chooses to make an election or revoke an election under section 168(k). Finally, no comments regarding the economic impact of these regulations on small entities were received. Consequently, the Treasury Department and the IRS hereby certify that these final regulations will not have a significant economic impact on a substantial number of small entities.

Pursuant to section 7805(f) of the Code, the proposed rule preceding this final rule was submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

IV. Unfunded Mandates Reform Act

Section 202 of the Unfunded Mandates Reform Act of 1995 requires that agencies assess anticipated costs and benefits and take certain other actions before issuing a final rule that includes any Federal mandate that may result in expenditures in any one year by a state, local, or tribal government, in the aggregate, or by the private sector, of \$100 million in 1995 dollars, updated annually for inflation. In 2019, that threshold is approximately \$154 million. These final regulations do not include any Federal mandate that may result in expenditures by state, local, or tribal

governments, or by the private sector in excess of that threshold.

V. Executive Order 13132: Federalism

Executive Order 13132 (entitled “Federalism”) prohibits an agency from publishing any rule that has federalism implications if the rule either imposes substantial, direct compliance costs on state and local governments, and is not required by statute, or preempts state law, unless the agency meets the consultation and funding requirements of section 6 of the Executive Order. These final regulations do not have federalism implications and do not impose substantial direct compliance costs on state and local governments or preempt state law within the meaning of the Executive Order.

VI. Congressional Review Act

The Administrator of the Office of Information and Regulatory Affairs of the OMB has determined that this Treasury decision is a major rule for purposes of the Congressional Review Act (5 U.S.C. 801 et seq.) (“CRA”). Under section 801(3) of the CRA, a major rule takes effect 60 days after the rule is published in the **Federal Register**. Notwithstanding this requirement, section 808(2) of the CRA allows

agencies to dispense with the requirements of section 801 of the CRA when the agency for good cause finds that such procedure would be impracticable, unnecessary, or contrary to the public interest and that the rule shall take effect at such time as the agency promulgating the rule determines.

Pursuant to section 808(2) of the CRA, the Treasury Department and the IRS find, for good cause, that a 60-day delay in the effective date is unnecessary and contrary to the public interest. The statutory provisions to which these rules relate were enacted on December 22, 2017 and apply to property acquired and placed in service after September 27, 2017. In most cases, two taxable years in which such property may have been placed in service have ended. This means that the statutory provisions are currently effective, and taxpayers may be subject to Federal income tax liability for their 2017 or 2018 taxable years reflecting these provisions. In many cases, taxpayers may be required to file returns reflecting this Federal income liability during the 60-day period that begins after this rule is published in the Federal Register.

These final regulations provide crucial guidance for taxpayers on how to apply the relevant statutory rules, compute their tax liability and accurately file their Federal income tax returns. These final regulations resolve statutory ambiguity, prevent abuse and grant taxpayer relief that would not be available based solely on the statute. Because taxpayers must already comply with the statute, a 60-day delay in the effective date of the final regulations is unnecessary and contrary to the public interest. A delay would place certain taxpayers in the unusual position of having to determine whether to file tax returns during the pre-effective date period based on final regulations that are not yet effective. If taxpayers chose not to follow the final regulations and did not amend their returns after the regulations became effective, it would place significant strain on the IRS to ensure that taxpayers correctly calculated their tax liabilities. For example, in cases where taxpayers self-construct property, a delayed effective date may hamper the IRS' ability to determine if such property was acquired after September 27, 2017. Moreover, a delayed effective date could create uncertainty

and possible restatements with respect to financial statement audits. Therefore, the rules in this Treasury decision are effective on the date of publication in the **Federal Register** and taxpayers may apply these rules to qualified property acquired and placed in service after September 27, 2017 in a taxable year ending on or after September 28, 2017.

The foregoing good cause statement only applies to the 60-day delayed effective date provision of section 801(3) of the CRA and is permitted under section 808(2) of the CRA. The Treasury Department and the IRS hereby comply with all aspects of the CRA and the Administrative Procedure Act (5 U.S.C. 551 et seq.).

Drafting Information

The principal authors of these final regulations are Kathleen Reed and Elizabeth R. Binder of the Office of Associate Chief Counsel (Income Tax and Accounting). However, other personnel from the Treasury Department and the IRS participated in their development.

List of Subjects in 26 CFR Part 1

Income taxes, Reporting and record-keeping requirements.

Adoption of Amendments to the Regulations

Accordingly, 26 CFR part 1 is amended as follows:

PART 1—INCOME TAXES

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

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

Par. 2. Section 1.48-12 is amended:

1. In the last sentence in paragraph (a)(2)(i), by removing "The last sentence" and adding "The next to last sentence" in its place;
2. By adding three sentences at the end of paragraph (a)(2)(i); and
3. By adding a sentence to the end of paragraph (c)(8)(i).

The additions read as follows:

§1.48-12 Qualified rehabilitated building; expenditures incurred after December 31, 1981.

(a) * * *

(2) * * *

(i) * * * The last sentence of paragraph (c)(8)(i) of this section applies to qualified rehabilitation expenditures that are qualified property under section 168(k)(2) and placed in service by a taxpayer during or after the taxpayer's taxable year that includes September 24, 2019. However, a taxpayer may choose to apply the last sentence in paragraph (c)(8)(i) of this section for qualified rehabilitation expenditures that are qualified property under section 168(k)(2) and acquired and placed in service after September 27, 2017, by the taxpayer during taxable years ending on or after September 28, 2017. A taxpayer may rely on the last sentence in paragraph (c)(8)(i) of this section in regulation project REG-104397-18 (2018-41 I.R.B. 558) (see §601.601(d)(2)(ii)(b) of this chapter) for qualified rehabilitation expenditures that are qualified property under section 168(k)(2) and acquired and placed in service after September 27, 2017, by the taxpayer during taxable years ending on or after September 28, 2017, and ending before the taxpayer's taxable year that includes September 24, 2019.

* * * * *

(c) * * *

(8) * * *

(i) * * * Further, see §1.168(k)-2(g)(9) if the qualified rehabilitation expenditures are qualified property under section 168(k), as amended by the Tax Cuts and Jobs Act, Public Law 115-97 (131 Stat. 2054 (December 22, 2017)).

* * * * *

Par. 3. Section 1.167(a)-14 is amended:

1. In the third sentence in paragraph (b)(1), by removing "under section 168(k)(2) or §1.168(k)-1," and adding "under section 168(k)(2) and §1.168(k)-1 or §1.168(k)-2, as applicable," in its place;
2. In the last sentence in paragraph (e)(3), by removing "and before 2010"; and
3. By adding three sentences at the end of paragraph (e)(3).

The additions read as follows:

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

* * * * *

(e) * * *

(3) * * * The language “or §1.168(k)-2, as applicable,” in the third sentence in paragraph (b)(1) of this section applies to computer software that is qualified property under section 168(k)(2) and placed in service by a taxpayer during or after the taxpayer’s taxable year that includes September 24, 2019. However, a taxpayer may choose to apply the language “or §1.168(k)-2, as applicable,” in the third sentence in paragraph (b)(1) of this section for computer software that is qualified property under section 168(k)(2) and acquired and placed in service after September 27, 2017, by the taxpayer during taxable years ending on or after September 28, 2017. A taxpayer may rely on the language “or §1.168(k)-2, as applicable,” in the third sentence in paragraph (b)(1) of this section in regulation project REG-104397-18 (2018-41 I.R.B. 558) (see §601.601(d)(2)(ii)(b) of this chapter) for computer software that is qualified property under section 168(k)(2) and acquired and placed in service after September 27, 2017, by the taxpayer during taxable years ending on or after September 28, 2017, and ending before the taxpayer’s taxable year that includes September 24, 2019.

Par. 4. Section 1.168(b)-1 is amended:

1. In the second sentence in paragraph (a)(3), by removing “under section 179, section 179C, or any similar provision,” and adding “under section 179, section 179C, section 181, or any similar provision,” in its place;
2. By adding paragraph (a)(5); and
3. By revising paragraph (b).

The addition and revision read as follows:

§1.168(b)-1 Definitions.

(a) * * *

(5) *Qualified improvement property.* (i) Is any improvement that is section 1250 property to an interior portion of a building, as defined in §1.48-1(e)(1), that is nonresidential real property, as defined in section 168(e)(2)(B), if the improvement is placed in service by the taxpayer after the date the building was first placed in service by any person and if—

(A) For purposes of section 168(e)(6), the improvement is placed in service by the taxpayer after December 31, 2017;

(B) For purposes of section 168(k)(3) as in effect on the day before amendment by section 13204(a)(4)(B) of the

Tax Cuts and Jobs Act, Public Law 115-97 (131 Stat. 2054 (December 22, 2017)) (“Act”), the improvement is acquired by the taxpayer before September 28, 2017, the improvement is placed in service by the taxpayer before January 1, 2018, and the improvement meets the original use requirement in section 168(k)(2)(A)(ii) as in effect on the day before amendment by section 13201(c)(1) of the Act; or

(C) For purposes of section 168(k)(3) as in effect on the day before amendment by section 13204(a)(4)(B) of the Act, the improvement is acquired by the taxpayer after September 27, 2017; the improvement is placed in service by the taxpayer after September 27, 2017, and before January 1, 2018; and the improvement meets the requirements in section 168(k)(2)(A)(ii) as amended by section 13201(c)(1) of the Act; and

(ii) Does not include any qualified improvement for which an expenditure is attributable to—

- (A) The enlargement, as defined in §1.48-12(c)(10), of the building;
- (B) Any elevator or escalator, as defined in §1.48-1(m)(2); or

(C) The internal structural framework, as defined in §1.48-12(b)(3)(iii), of the building.

(b) *Applicability date—(1) In general.* Except as provided in paragraph (b)(2) of this section, this section is applicable on or after February 27, 2004.

(2) *Application of paragraph (a)(5) of this section and addition of “section 181” in paragraph (a)(3) of this section—(i)*

In general. Except as provided in paragraphs (b)(2)(ii) and (iii) of this section, paragraph (a)(5) of this section and the language “section 181,” in the second sentence in paragraph (a)(3) of this section are applicable on or after September 24, 2019.

(ii) *Early application of paragraph (a)(5) of this section and addition of “section 181” in paragraph (a)(3) of this section.* A taxpayer may choose to apply paragraph (a)(5) of this section and the language “section 181,” in the second sentence in paragraph (a)(3) of this section for the taxpayer’s taxable years ending on or after September 28, 2017.

(iii) *Early application of regulation project REG-104397-18.* A taxpayer may rely on the provisions of paragraph (a)

(5) of this section in regulation project REG-104397-18 (2018-41 I.R.B 558) (see §601.601(d)(2)(ii)(b) of this chapter) for the taxpayer’s taxable years ending on or after September 28, 2017, and ending before the taxpayer’s taxable year that includes September 24, 2019.

Par. 5. Section 1.168(d)-1 is amended by adding a sentence at the end of paragraphs (b)(3)(ii) and (b)(7)(ii) and adding three sentences at the end of paragraph (d)(2) to read as follows:

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

* * * * *

(b) * * *

(3) * * *

(ii) * * * Further, see §1.168(k)-2(g)(1) for rules relating to qualified property under section 168(k), as amended by the Tax Cuts and Jobs Act, Public Law 115-97 (131 Stat. 2054 (December 22, 2017)), that is placed in service by the taxpayer in the same taxable year in which either a partnership is terminated as a result of a technical termination under section 708(b)(1)(B) or the property is transferred in a transaction described in section 168(i)(7).

* * * * *

(7) * * *

(ii) * * * However, see §1.168(k)-2(g)(1)(iii) for a special rule regarding the allocation of the additional first year depreciation deduction in the case of certain contributions of property to a partnership under section 721.

* * * * *

(d) * * *

(2) * * * The last sentences in paragraphs (b)(3)(ii) and (b)(7)(ii) of this section apply to qualified property under section 168(k)(2) placed in service by a taxpayer during or after the taxpayer’s taxable year that includes September 24, 2019. However, a taxpayer may choose to apply the last sentences in paragraphs (b)(3)(ii) and (b)(7)(ii) of this section to qualified property under section 168(k)(2) acquired and placed in service after September 27, 2017, by the taxpayer during taxable years ending on or after September 28, 2017. A taxpayer may rely on the last sentences in paragraphs (b)(3)(ii) and (b)(7)(ii) of this section in regulation project REG-104397-18 (2018-41 I.R.B. 558) (see §601.601(d)(2)(ii)(b) of this chapter) for qualified property under section

168(k)(2) acquired and placed in service after September 27, 2017, by the taxpayer during taxable years ending on or after September 28, 2017, and ending before the taxpayer's taxable year that includes September 24, 2019.

* * * *

Par. 6. Section 1.168(i)-4 is amended:

1. In the penultimate sentence in paragraph (b)(1), by removing “§§1.168(k)-1T(f)(6)(iii) and 1.1400L(b)-1T(f)(6)” and adding “§1.168(k)-1(f)(6)(iii) or 1.168(k)-2(g)(6)(iii), as applicable, and §1.1400L(b)-1(f)(6)” in its place;
2. In the fifth sentence in paragraph (c), by removing “§§1.168(k)-1T(f)(6)(ii) and 1.1400L(b)-1T(f)(6)” and adding “§1.168(k)-1(f)(6)(ii) or 1.168(k)-2(g)(6)(ii), as applicable, and §1.1400L(b)-1(f)(6)” in its place;
3. In the second sentence in paragraph (d)(3)(i)(C), by removing “§§1.168(k)-1T(f)(6)(iv) and 1.400L(b)-1T(f)(6)” and adding “§1.168(k)-1(f)(6)(iv) or 1.168(k)-2(g)(6)(iv), as applicable, and §1.400L(b)-1(f)(6)” in its place;
4. In the last sentence in paragraph (d)(4)(i), by removing “§§1.168(k)-1T(f)(6)(iv) and 1.1400L(b)-1T(f)(6)” and adding “§1.168(k)-1(f)(6)(iv) or 1.168(k)-2(g)(6)(iv), as applicable, and §1.400L(b)-1(f)(6)” in its place;
5. By revising the first sentence in paragraph (g)(1); and
6. By redesignating paragraph (g)(2) as paragraph (g)(3) and adding new paragraph (g)(2).

The revision and addition read as follows:

§1.168(i)-4 Changes in use.

* * * *

(g) * * *

(1) * * * Except as provided in paragraph (g)(2) of this section, this section applies to any change in the use of MACRS property in a taxable year ending on or after June 17, 2004. * * *

(2) *Qualified property under section 168(k) acquired and placed in service after September 27, 2017—(i) In general.* The language “or §1.168(k)-2(g)(6)(iii), as applicable” in paragraph (b)(1) of this section, the language “or §1.168(k)-2(g)(6)(ii), as applicable” in paragraph (c) of this section, and the language “or

§1.168(k)-2(g)(6)(iv), as applicable” in paragraphs (d)(3)(i)(C) and (d)(4)(i) of this section applies to any change in use of MACRS property, which is qualified property under section 168(k)(2), by a taxpayer during or after the taxpayer's taxable year that includes September 24, 2019.

(ii) *Early application.* A taxpayer may choose to apply the language “or §1.168(k)-2(g)(6)(iii), as applicable” in paragraph (b)(1) of this section, the language “or §1.168(k)-2(g)(6)(ii), as applicable” in paragraph (c) of this section, and the language “or §1.168(k)-2(g)(6)(iv), as applicable” in paragraphs (d)(3)(i)(C) and (d)(4)(i) of this section for any change in use of MACRS property, which is qualified property under section 168(k)(2) and acquired and placed in service after September 27, 2017, by the taxpayer during taxable years ending on or after September 28, 2017.

(iii) *Early application of regulation project REG-104397-18.* A taxpayer may rely on the language “or §1.168(k)-2(f)(6)(iii), as applicable” in paragraph (b)(1) of this section, the language “or §1.168(k)-2(f)(6)(ii), as applicable” in paragraph (c) of this section, and the language “or §1.168(k)-2(f)(6)(iv), as applicable” in paragraphs (d)(3)(i)(C) and (d)(4)(i) of this section in regulation project REG-104397-18 (2018-41 I.R.B. 558) (see §601.601(d)(2)(ii)(b) of this chapter) for any change in use of MACRS property, which is qualified property under section 168(k)(2) and acquired and placed in service after September 27, 2017, by the taxpayer during taxable years ending on or after September 28, 2017, and ending before the taxpayer's taxable year that includes September 24, 2019.

* * * *

Par. 7. Section 1.168(i)-6 is amended:

1. In paragraph (d)(3)(ii)(B), by removing “1.168(k)-1(f)(5) or §1.1400L(b)-1(f)(5)” wherever it appears and adding “1.168(k)-1(f)(5), §1.168(k)-2(g)(5), or §1.1400L(b)-1(f)(5)” in its place;
2. In paragraph (d)(3)(ii)(E), by removing “1.168(k)-1(f)(5) or §1.1400L(b)-1(f)(5)” and adding “1.168(k)-1(f)(5), §1.168(k)-2(g)(5), or §1.1400L(b)-1(f)(5)” in its place;

3. By adding a sentence at the end of paragraph (d)(4);
4. By adding a sentence at the end of paragraph (h);
5. By revising paragraph (k)(1); and
6. By adding paragraph (k)(4).

The additions and revision read as follows:

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

* * * *

(4) * * * Further, see §1.168(k)-2(g)(5)(iv) for replacement MACRS property that is qualified property under section 168(k), as amended by the Tax Cuts and Jobs Act, Public Law 115-97 (131 Stat. 2054 (December 22, 2017)).

* * * *

(h) * * * Further, see §1.168(k)-2(g)(5) for qualified property under section 168(k), as amended by the Tax Cuts and Jobs Act, Public Law 115-97 (131 Stat. 2054 (December 22, 2017)).

* * * *

(k) ***
(1) *In general.* Except as provided in paragraphs (k)(3) and (4) of this section, this section applies to a like-kind exchange or an involuntary conversion of MACRS property for which the time of disposition and the time of replacement both occur after February 27, 2004.

* * * *

(4) *Qualified property under section 168(k) acquired and placed in service after September 27, 2017—(i) In general.* The language “1.168(k)-2(g)(5),” in paragraphs (d)(3)(ii)(B) and (E) of this section and the final sentence in paragraphs (d)(4) and (h) of this section apply to a like-kind exchange or an involuntary conversion of MACRS property, which is qualified property under section 168(k)(2), for which the time of replacement occurs on or after September 24, 2019.

(ii) *Early application.* A taxpayer may choose to apply the language “1.168(k)-2(g)(5),” in paragraphs (d)(3)(ii)(B) and (E) of this section and the final sentence in paragraphs (d)(4) and (h) of this section to a like-kind exchange or an involuntary conversion of MACRS property, which is qualified property under section 168(k)(2), for which the time of replacement occurs on or after September 28, 2017.

(iii) *Early application of regulation project REG-104397-18.* A taxpayer may rely on the language “1.168(k)-2(f)(5)” in paragraphs (d)(3)(ii)(B) and (E) of this section and the final sentence in paragraphs (d)(4) and (h) of this section in regulation project REG-104397-18 (2018-41 I.R.B. 558) (see §601.601(d)(2)(ii)(b) of this chapter) for a like-kind exchange or an involuntary conversion of MACRS property, which is qualified property under section 168(k)(2), for which the time of replacement occurs on or after September 28, 2017, and occurs before September 24, 2019.

Par. 8. Section 1.168(k)-0 is amended by revising the introductory text and adding an entry for §1.168(k)-2 in numerical order to the table of contents to read as follows:

§1.168(k)-0 Table of contents.

This section lists the major paragraphs contained in §§1.168(k)-1 and 1.168(k)-2.

* * * *

§1.168(k)-2 Additional first year depreciation deduction for property acquired and placed in service after September 27, 2017.

- (a) Scope and definitions.
 - (1) Scope.
 - (2) Definitions.
 - (b) Qualified property.
 - (1) In general.
 - (2) Description of qualified property.
 - (i) In general.
 - (ii) Property not eligible for additional first year depreciation deduction.
 - (iii) Examples.
 - (3) Original use or used property acquisition requirements.
 - (i) In general.
 - (ii) Original use.
 - (A) In general.
 - (B) Conversion to business or income-producing use.
 - (C) Fractional interests in property.
 - (iii) Used property acquisition requirements.
 - (A) In general.
 - (B) Property was not used by the taxpayer at any time prior to acquisition.
 - (C) [Reserved]
 - (iv) Application to partnerships.
 - (A) Section 704(c) remedial allocations.
 - (B) Basis determined under section 732.

- (C) Section 734(b) adjustments.
- (D) Section 743(b) adjustments.
- (v) [Reserved]
- (vi) Syndication transaction.
- (vii) Examples.
- (4) Placed-in-service date.
 - (i) In general.
 - (ii) Specified plant.
 - (iii) Qualified film, television, or live theatrical production.
 - (A) Qualified film or television production.
 - (B) Qualified live theatrical production.
 - (iv) Syndication transaction.
 - (v) Technical termination of a partnership.
 - (vi) Section 168(i)(7) transactions.
- (5) Acquisition of property.
 - (i) In general.
 - (ii) Acquisition date.
 - (A) In general.
 - (B) Determination of acquisition date for property acquired pursuant to a written binding contract.
 - (iii) Definition of binding contract.
 - (A) In general.
 - (B) Conditions.
 - (C) Options.
 - (D) Letter of intent.
 - (E) Supply agreements.
 - (F) Components.
 - (G) [Reserved]
 - (iv) Self-constructed property.
 - (A) In general.
 - (B) When does manufacture, construction, or production begin.
 - (C) Components of self-constructed property.
 - (v) [Reserved]
 - (vi) Qualified film, television, or live theatrical production.
 - (A) Qualified film or television production.
 - (B) Qualified live theatrical production.
 - (vii) Specified plant.
 - (viii) Examples.
 - (c) [Reserved]
 - (d) Property described in section 168(k)(2)(B) or (C).
 - (1) In general.
 - (2) Definition of binding contract.
 - (3) Self-constructed property.
 - (i) In general.
 - (ii) When does manufacture, construction, or production begin.
 - (A) In general.
 - (B) Safe harbor.
 - (iii) Components of self-constructed property.
 - (A) Acquired components.
 - (B) Self-constructed components.
 - (iv) Examples.
 - (e) Computation of depreciation deduction for qualified property.
 - (1) Additional first year depreciation deduction.
 - (i) Allowable taxable year.
 - (ii) Computation.
 - (iii) Property described in section 168(k)(2)(B).
 - (iv) Alternative minimum tax.
 - (A) In general.
 - (B) Special rules.
 - (2) Otherwise allowable depreciation deduction.
 - (i) In general.
 - (ii) Alternative minimum tax.
 - (3) Examples.
 - (f) Elections under section 168(k).
 - (1) Election not to deduct additional first year depreciation.
 - (i) In general.
 - (ii) Definition of class of property.
 - (iii) Time and manner for making election.
 - (A) Time for making election.
 - (B) Manner of making election.
 - (iv) Failure to make election.
 - (2) Election to apply section 168(k)(5) for specified plants.
 - (i) In general.
 - (ii) Time and manner for making election.
 - (A) Time for making election.
 - (B) Manner of making election.
 - (iii) Failure to make election.
 - (3) Election for qualified property placed in service during the 2017 taxable year.
 - (i) In general.
 - (ii) Time and manner for making election.
 - (A) Time for making election.
 - (B) Manner of making election.
 - (iii) Failure to make election.
 - (4) Alternative minimum tax.
 - (5) Revocation of election.
 - (i) In general.
 - (ii) Automatic 6-month extension.
 - (6) Special rules for 2016 and 2017 returns.
 - (g) Special rules.

- (1) Property placed in service and disposed of in the same taxable year.
 - (i) In general.
 - (ii) Technical termination of a partnership.
 - (iii) Section 168(i)(7) transactions.
 - (iv) Examples.
 - (2) Redetermination of basis.
 - (i) Increase in basis.
 - (ii) Decrease in basis.
 - (iii) Definitions.
 - (iv) Examples.
 - (3) Sections 1245 and 1250 depreciation recapture.
 - (4) Coordination with section 169.
 - (5) Like-kind exchanges and involuntary conversions.
 - (i) Scope.
 - (ii) Definitions.
 - (iii) Computation.
 - (A) In general.
 - (B) Year of disposition and year of replacement.
 - (C) Property described in section 168(k)(2)(B).
 - (D) Effect of §1.168(i)-6(i)(1) election.
 - (E) Alternative minimum tax.
 - (iv) Replacement MACRS property or replacement computer software that is acquired and placed in service before disposition of relinquished MACRS property or relinquished computer software.
 - (v) Examples.
 - (6) Change in use.
 - (i) Change in use of MACRS property.
 - (ii) Conversion to personal use.
 - (iii) Conversion to business or income-producing use.
 - (A) During the same taxable year.
 - (B) Subsequent to the acquisition year.
 - (iv) Depreciable property changes use subsequent to the placed-in-service year.
 - (v) Examples.
 - (7) Earnings and profits.
 - (8) Limitation of amount of depreciation for certain passenger automobiles.
 - (9) Coordination with section 47.
 - (i) In general.
 - (ii) Example.
 - (10) Coordination with section 514(a)(3).
 - (11) [Reserved]
 - (h) Applicability dates.
 - (1) In general.
 - (2) Early application of this section.
 - (3) Early application of regulation project REG-104397-18.

Par. 9. Section 1.168(k)-2 is added to read as follows:

§1.168(k)-2 Additional first year depreciation deduction for property acquired and placed in service after September 27, 2017.

(a) *Scope and definitions*—(1) *Scope*. This section provides rules for determining the additional first year depreciation deduction allowable under section 168(k) for qualified property acquired and placed in service after September 27, 2017.

(2) *Definitions*. For purposes of this section—

- (i) *Act* is the Tax Cuts and Jobs Act, Public Law 115-97 (131 Stat. 2054 (December 22, 2017));
- (ii) *Applicable percentage* is the percentage provided in section 168(k)(6);
- (iii) *Initial live staged performance* is the first commercial exhibition of a production to an audience. However, the term *initial live staged performance* does not include limited exhibition prior to commercial exhibition to general audiences if the limited exhibition is primarily for purposes of publicity, determining the need for further production activity, or raising funds for the completion of production. For example, an initial live staged performance does not include a preview of the production if the preview is primarily to determine the need for further production activity; and
- (iv) *Predecessor* includes—
 - (A) A transferor of an asset to a transferee in a transaction to which section 381(a) applies;
 - (B) A transferor of an asset to a transferee in a transaction in which the transferee's basis in the asset is determined, in whole or in part, by reference to the basis of the asset in the hands of the transferor;
 - (C) A partnership that is considered as continuing under section 708(b)(2) and §1.708-1;
 - (D) The decedent in the case of an asset acquired by the estate; or
 - (E) A transferor of an asset to a trust.

(b) *Qualified property*—(1) *In general*. Qualified property is depreciable property, as defined in §1.168(b)-1(a)(1), 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)-2(b)(2) (description of qualified property);
 - (ii) The requirements in §1.168(k)-2(b)(3) (original use or used property acquisition requirements);
 - (iii) The requirements in §1.168(k)-2(b)(4) (placed-in-service date); and
 - (iv) The requirements in §1.168(k)-2(b)(5) (acquisition of property).
- (2) *Description of qualified 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(b)-1(a)(2), that has a recovery period of 20 years or less. For purposes of this paragraph (b)(2)(i)(A) and section 168(k)(2)(A)(i)(I), the recovery period is determined in accordance with section 168(c) regardless of any election made by the taxpayer under section 168(g)(7). This paragraph (b)(2)(i)(A) includes the following MACRS property that is acquired by the taxpayer after September 27, 2017, and placed in service by the taxpayer after September 27, 2017, and before January 1, 2018:
 - (1) Qualified leasehold improvement property as defined in section 168(e)(6) as in effect on the day before amendment by section 13204(a)(1) of the Act;
 - (2) Qualified restaurant property, as defined in section 168(e)(7) as in effect on the day before amendment by section 13204(a)(1) of the Act, that is qualified improvement property as defined in §1.168(b)-1(a)(5)(i)(C) and (a)(5)(ii); and
 - (3) Qualified retail improvement property as defined in section 168(e)(8) as in effect on the day before amendment by section 13204(a)(1) of the Act;
 - (B) Computer software as defined in, and depreciated under, section 167(f)(1) and §1.167(a)-14;
 - (C) Water utility property as defined in section 168(e)(5) and depreciated under section 168;
 - (D) Qualified improvement property as defined in §1.168(b)-1(a)(5)(i)(C) and (a)(5)(ii) and depreciated under section 168;
 - (E) A qualified film or television production, as defined in section 181(d) and §1.181-3, for which a deduction would have been allowable under section 181 and §§1.181-1 through 1.181-6 without regard to section 181(a)(2) and (g), §1.181-1(b)(1)(i) and (ii), and (b)(2)(i),

or section 168(k). Only production costs of a qualified film or television production are allowable as a deduction under section 181 and §§1.181-1 through 1.181-6 without regard, for purposes of section 168(k), to section 181(a)(2) and (g), §1.181-1(b)(1)(i) and (ii), and (b)(2)(i). The taxpayer that claims the additional first year depreciation deduction under this section for the production costs of a qualified film or television production must be the owner, as defined in §1.181-1(a)(2), of the qualified film or television production. See §1.181-1(a)(3) for the definition of production costs;

(F) A qualified live theatrical production, as defined in section 181(e), for which a deduction would have been allowable under section 181 and §§1.181-1 through 1.181-6 without regard to section 181(a)(2) and (g), §1.181-1(b)(1)(i) and (ii), and (b)(2)(i), or section 168(k). Only production costs of a qualified live theatrical production are allowable as a deduction under section 181 and §§1.181-1 through 1.181-6 without regard, for purposes of section 168(k), to section 181(a)(2) and (g), §1.181-1(b)(1)(i) and (ii), and (b)(2)(i). The taxpayer that claims the additional first year depreciation deduction under this section for the production costs of a qualified live theatrical production must be the owner, as defined in §1.181-1(a)(2), of the qualified live theatrical production. In applying §1.181-1(a)(2)(ii) to a person that acquires a finished or partially-finished qualified live theatrical production, such person is treated as an owner of that production, but only if the production is acquired prior to its initial live staged performance. Rules similar to the rules in §1.181-1(a)(3) for the definition of production costs of a qualified film or television production apply for defining production costs of a qualified live theatrical production; or

(G) A specified plant, as defined in section 168(k)(5)(B), for which the taxpayer has properly made an election to apply section 168(k)(5) for the taxable year in which the specified plant is planted, or grafted to a plant that has already been planted, by the taxpayer in the ordinary course of the taxpayer's farming business, as defined in section 263A(e)(4) (for further guidance, see paragraph (f) of this section).

(ii) *Property not eligible for additional first year depreciation deduction.* Depreciable property will not meet the requirements of this paragraph (b)(2) if the property is—

(A) Described in section 168(f) (for example, automobiles for which the taxpayer uses the optional business standard mileage rate);

(B) Required to be depreciated under the alternative depreciation system of section 168(g) pursuant to section 168(g)(1)(A), (B), (C), (D), (F), or (G), 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)). If section 168(h)(6) applies to the property, only the tax-exempt entity's proportionate share of the property, as determined under section 168(h)(6), is treated as tax-exempt use property described in section 168(g)(1)(B) and in this paragraph (b)(2)(ii)(B). This paragraph (b)(2)(ii)(B) does not apply to property for which the adjusted basis is required to be determined using the alternative depreciation system of section 168(g) pursuant to section 250(b)(2)(B) or 951A(d)(3), as applicable, or to property for which the adjusted basis is required to be determined using the alternative depreciation system of section 168(g) for allocating business interest expense between excepted and non-excepted trades or businesses under section 163(j), but only if the property is not required to be depreciated under the alternative depreciation system of section 168(g) pursuant to section 168(g)(1)(A), (B), (C), (D), (F), or (G), or other provisions of the Code, other than section 163(j), 250(b)(2)(B), or 951A(d)(3), as applicable;

(C) Included in any class of property for which the taxpayer elects not to deduct the additional first year depreciation (for further guidance, see paragraph (f) of this section);

(D) A specified plant that is placed in service by the taxpayer during the taxable year and for which the taxpayer made an election to apply section 168(k)(5) for a prior taxable year;

(E) Included in any class of property for which the taxpayer elects to apply sec-

tion 168(k)(4). This paragraph (b)(2)(ii)(E) applies to property placed in service by the taxpayer in any taxable year beginning before January 1, 2018;

(F) Primarily used in a trade or business described in section 163(j)(7)(A)(iv), and placed in service by the taxpayer in any taxable year beginning after December 31, 2017; or

(G) Used in a trade or business that has had floor plan financing indebtedness, as defined in section 163(j)(9), if the floor plan financing interest, as defined in section 163(j)(9), related to such indebtedness is taken into account under section 163(j)(1)(C) for the taxable year. Such property also must be placed in service by the taxpayer in any taxable year beginning after December 31, 2017.

(iii) *Examples.* The application of this paragraph (b)(2) is illustrated by the following examples. Unless the facts specifically indicate otherwise, assume that the parties are not related within the meaning of section 179(d)(2)(A) or (B) and §1.179-4(c), and are not described in section 163(j)(3):

(A) *Example 1.* On February 8, 2018, *A* finishes the production of a qualified film, as defined in §1.181-3. On June 4, 2018, *B* acquires this finished production from *A*. The initial release or broadcast, as defined in §1.181-1(a)(7), of this qualified film is on July 28, 2018. Because *B* acquired the qualified film before its initial release or broadcast, *B* is treated as the owner of the qualified film for purposes of section 181 and §§1.181-1 through 1.181-6, other than section 181(a)(2) and (g), and §1.181-1(b)(1)(i) and (ii), and (b)(2)(i), are met, *B*'s acquisition cost of the qualified film qualifies for the additional first year depreciation deduction under this section.

(B) *Example 2.* The facts are the same as in *Example 1* of paragraph (b)(2)(iii)(A) of this section, except that *B* acquires a limited license or right to release the qualified film in Europe. As a result, *B* is not treated as the owner of the qualified film pursuant to §1.181-1(a)(2). Accordingly, paragraph (b)(2)(i)(E) of this section is not satisfied, and *B*'s acquisition cost of the license or right does not qualify for the additional first year depreciation deduction.

(C) *Example 3.* *C* owns a film library. All of the films in this film library are completed and have been released or broadcasted. In 2018, *D* buys this film library from *C*. Because *D* acquired the films after their initial release or broadcast, *D*'s acquisition cost of the film library does not qualify for a deduction under section 181. As a result, paragraph (b)(2)(i)(E) of this section is not satisfied, and *D*'s acquisition cost of the film library does not qualify for the additional first year depreciation deduction.

(D) *Example 4.* During 2019, *E* Corporation, a domestic corporation, acquired new equipment for

use in its manufacturing trade or business in Mexico. To determine its qualified business asset investment for purposes of section 250, E Corporation must determine the adjusted basis of the new equipment using the alternative depreciation system of section 168(g) pursuant to sections 250(b)(2)(B) and 951A(d)(3). E Corporation also is required to depreciate the new equipment under the alternative depreciation system of section 168(g) pursuant to section 168(g)(1)(A). As a result, the new equipment does not qualify for the additional first year depreciation deduction pursuant to paragraph (b)(2)(ii)(B) of this section.

(E) *Example 5.* The facts are the same as in *Example 4* of paragraph (b)(2)(iii)(D) of this section, except E Corporation acquired the new equipment for use in its manufacturing trade or business in California. The new equipment is not described in section 168(g)(1)(A), (B), (C), (D), (F), or (G). No other provision of the Internal Revenue Code, other than section 250(b)(2)(B) or 951A(d)(3), requires the new equipment to be depreciated using the alternative depreciation system of section 168(g). To determine its qualified business asset investment for purposes of section 250, E Corporation must determine the adjusted basis of the new equipment using the alternative depreciation system of section 168(g) pursuant to sections 250(b)(2)(B) and 951A(d)(3). Because E Corporation is not required to depreciate the new equipment under the alternative depreciation system of section 168(g), paragraph (b)(2)(ii)(B) of this section does not apply to this new equipment. Assuming all other requirements are met, the new equipment qualifies for the additional first year depreciation deduction under this section.

(3) *Original use or used property acquisition requirements—(i) In general.* Depreciable property will meet the requirements of this paragraph (b)(3) if the property meets the original use requirements in paragraph (b)(3)(ii) of this section or if the property meets the used property acquisition requirements in paragraph (b)(3)(iii) of this section.

(ii) *Original use—(A) In general.* Depreciable property will meet the requirements of this paragraph (b)(3)(ii) if the original use of the property commences with the taxpayer. Except as provided in paragraphs (b)(3)(ii)(B) and (C) 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. Additional capital expenditures paid or incurred by a taxpayer to recondition or rebuild property acquired or owned by the taxpayer satisfy the original use requirement. However, the cost of reconditioned or rebuilt property does not satisfy the original use requirement (but may satisfy the used property acquisition requirements in paragraph (b)(3)(iii) of this section). The question

of whether property is reconditioned or rebuilt property is a question of fact. For purposes of this paragraph (b)(3)(ii)(A), 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.

(B) *Conversion to business or income-producing use—(1) 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.

(2) *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)(2), 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.

(C) *Fractional interests in property.* If, in the ordinary course of its business, a taxpayer sells fractional interests in new 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)(ii)(C), persons are not related if they do not have a relationship described in section 267(b) and §1.267(b)-1, or section 707(b) and §1.707-1.

(iii) *Used property acquisition requirements—(A) In general.* Depreciable property will meet the requirements of this paragraph (b)(3)(iii) if the acquisition of the used property meets the following requirements:

(1) Such property was not used by the taxpayer or a predecessor at any time prior to such acquisition;

(2) The acquisition of such property meets the requirements of section 179(d)(2)(A), (B), and (C), and §1.179-4(c)(1)(ii), (iii), and (iv); or §1.179-4(c)(2) (property is acquired by purchase); and

(3) The acquisition of such property meets the requirements of section 179(d)(3) and §1.179-4(d) (cost of property) (for further guidance regarding like-kind exchanges and involuntary conversions, see paragraph (g)(5) of this section).

(B) *Property was not used by the taxpayer at any time prior to acquisition—(I) In general.* Solely for purposes of paragraph (b)(3)(iii)(A)(1) of this section, the property is treated as used by the taxpayer or a predecessor at any time prior to acquisition by the taxpayer or predecessor if the taxpayer or the predecessor had a depreciable interest in the property at any time prior to such acquisition, whether or not the taxpayer or the predecessor claimed depreciation deductions for the property. To determine if the taxpayer or a predecessor had a depreciable interest in the property at any time prior to acquisition, only the five calendar years immediately prior to the taxpayer's current placed-in-service year of the property is taken into account. If the taxpayer and a predecessor have not been in existence for this entire five-year period, only the number of calendar years the taxpayer and

the predecessor have been in existence is taken into account. If a lessee has a depreciable interest in the improvements made to leased property and subsequently the lessee acquires the leased property of which the improvements are a part, the unadjusted depreciable basis, as defined in §1.168(b)-1(a)(3), of the acquired property that is eligible for the additional first year depreciation deduction, assuming all other requirements are met, must not include the unadjusted depreciable basis attributable to the improvements.

(2) *Taxpayer has a depreciable interest in a portion of the property.* If a taxpayer initially acquires a depreciable interest in a portion of the property and subsequently acquires a depreciable interest in an additional portion of the same property, such additional depreciable interest is not treated as used by the taxpayer at any time prior to its acquisition by the taxpayer under paragraphs (b)(3)(iii)(A)(1) and (b)(3)(iii)(B)(1) of this section. This paragraph (b)(3)(iii)(B)(2) does not apply if the taxpayer or a predecessor previously had a depreciable interest in the subsequently acquired additional portion. For purposes of this paragraph (b)(3)(iii)(B)(2), a portion of the property is considered to be the percentage interest in the property. If a taxpayer holds a depreciable interest in a portion of the property, sells that portion or a part of that portion, and subsequently acquires a depreciable interest in another portion of the same property, the taxpayer will be treated as previously having a depreciable interest in the property up to the amount of the portion for which the taxpayer held a depreciable interest in the property before the sale.

(3) *Substantial renovation of property.* If a taxpayer acquires and places in service substantially renovated property and the taxpayer or a predecessor previously had a depreciable interest in the property before it was substantially renovated, the taxpayer's or predecessor's depreciable interest in the property before it was substantially renovated is not taken into account for determining whether the substantially renovated property was used by the taxpayer or a predecessor at any time prior to its acquisition by the taxpayer under paragraphs (b)(3)(iii)(A)(1) and (b)(3)(iii)(B)(1) of this section. For purposes of this paragraph (b)(3)(iii)(B)(3), property

is substantially renovated if the cost of the used parts is not more than 20 percent of the total cost of the substantially renovated property, whether acquired or self-constructed.

(C) [Reserved]

(iv) *Application to partnerships—(A) Section 704(c) remedial allocations.* Remedial allocations under section 704(c) do not satisfy the requirements of paragraph (b)(3) of this section. See §1.704-3(d)(2).

(B) *Basis determined under section 732.* Any basis of distributed property determined under section 732 does not satisfy the requirements of paragraph (b)(3) of this section.

(C) *Section 734(b) adjustments.* Any increase in basis of depreciable property under section 734(b) does not satisfy the requirements of paragraph (b)(3) of this section.

(D) *Section 743(b) adjustments—(1) In general.* For purposes of determining whether the transfer of a partnership interest meets the requirements of paragraph (b)(3)(iii)(A) of this section, each partner is treated as having a depreciable interest in the partner's proportionate share of partnership property. Any increase in basis of depreciable property under section 743(b) satisfies the requirements of paragraph (b)(3)(iii)(A) of this section if—

(i) At any time prior to the transfer of the partnership interest that gave rise to such basis increase, neither the transferee partner nor a predecessor of the transferee partner had any depreciable interest in the portion of the property deemed acquired to which the section 743(b) adjustment is allocated under section 755 and §1.755-1; and

(ii) The transfer of the partnership interest that gave rise to such basis increase satisfies the requirements of paragraphs (b)(3)(iii)(A)(2) and (3) of this section.

(2) *Relatedness tested at partner level.* Solely for purposes of paragraph (b)(3)(iv)(D)(1)(ii) of this section, whether the parties are related or unrelated is determined by comparing the transferor and the transferee of the transferred partnership interest.

(v) [Reserved]

(vi) *Syndication transaction.* If new property is acquired and placed in service by a lessor, or if used property is acquired and placed in service by a lessor and the

lessor or a predecessor did not previously have a depreciable interest in the used property, and the property 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 taxpayer that acquired the property for purposes of applying paragraphs (b)(3)(ii) and (iii) of this section. The purchaser of the property in the last sale during the three-month period is treated, for purposes of applying paragraph (b)(3) of this section, as—

(A) The original user of the property in this transaction if the lessor acquired and placed in service new property; or

(B) The taxpayer having the depreciable interest in the property in this transaction if the lessor acquired and placed in service used property.

(vii) *Examples.* The application of this paragraph (b)(3) is illustrated by the following examples. Unless the facts specifically indicate otherwise, assume that the parties are not related within the meaning of section 179(d)(2)(A) or (B) and §1.179-4(c), no corporation is a member of a consolidated or controlled group, and the parties do not have predecessors:

(A) *Example 1.* (1) On August 1, 2018, A buys a new machine for \$35,000 from an unrelated party for use in A's trade or business. On July 1, 2020, B buys that machine from A for \$20,000 for use in B's trade or business. On October 1, 2020, B makes a \$5,000 capital expenditure to recondition the machine. B did not have any depreciable interest in the machine before B acquired it on July 1, 2020.

(2) A's purchase price of \$35,000 satisfies the original use requirement of paragraph (b)(3)(ii) of this section and, assuming all other requirements are met, qualifies for the additional first year depreciation deduction under this section.

(3) B's purchase price of \$20,000 does not satisfy the original use requirement of paragraph (b)(3)(ii) of this section, but it does satisfy the used property acquisition requirements of paragraph (b)(3)(iii) of this section. Assuming all other requirements are

met, the \$20,000 purchase price qualifies for the additional first year depreciation deduction under this section. Further, *B*'s \$5,000 expenditure satisfies the original use requirement of paragraph (b)(3)(ii) of this section and, assuming all other requirements are met, qualifies for the additional first year depreciation deduction under this section, regardless of whether the \$5,000 is added to the basis of the machine or is capitalized as a separate asset.

(B) *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 November 1, 2017, *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 paragraph (b)(3)(ii) of this section. Assuming all other requirements are met, *D*'s purchase price of the automobile qualifies for the additional first year depreciation deduction for *D* under this section, subject to any limitation under section 280F.

(C) *Example 3.* On April 1, 2015, *E* acquires a horse to be used in *E*'s thoroughbred racing business. On October 1, 2018, *F* buys the horse from *E* and will use the horse in *F*'s horse breeding business. *F* did not have any depreciable interest in the horse before *F* acquired it on October 1, 2018. The use of the horse by *E* in its racing business prevents *F* from satisfying the original use requirement of paragraph (b)(3)(ii) of this section. However, *F*'s acquisition of the horse satisfies the used property acquisition requirements of paragraph (b)(3)(iii) of this section. Assuming all other requirements are met, *F*'s purchase price of the horse qualifies for the additional first year depreciation deduction for *F* under this section.

(D) *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 October 1, 2017, *G* sells five of the eight fractional interests in the aircraft to *H* and *H* begins to use its proportionate share of the aircraft immediately upon purchase. On February 1, 2018, *G* sells to *I* the remaining unsold $\frac{3}{8}$ fractional interests in the aircraft. *H* is considered the original user as to its $\frac{5}{8}$ fractional interest in the aircraft and *I* is considered the original user as to its $\frac{3}{8}$ fractional interest in the aircraft. Thus, assuming all other requirements are met, *H*'s purchase price for its $\frac{5}{8}$ fractional interest in the aircraft qualifies for the additional first year depreciation deduction under this section and *I*'s purchase price for its $\frac{3}{8}$ fractional interest in the aircraft qualifies for the additional first year depreciation deduction under this section.

(E) *Example 5.* On September 1, 2017, *J*, an equipment dealer, buys new tractors that are held by *J* primarily for sale to customers in the ordinary course of its business. On October 15, 2017, *J* withdraws the tractors from inventory and begins to use the tractors primarily for producing rental income. The holding of the tractors by *J* as inventory does not constitute a "use" for purposes of the original use requirement and, therefore, the original use of the

tractors commences with *J* on October 15, 2017, for purposes of paragraph (b)(3)(ii) of this section. However, the tractors are not eligible for the additional first year depreciation deduction under this section because *J* acquired the tractors before September 28, 2017.

(F) *Example 6.* *K* is in the trade or business of leasing equipment to others. During 2016, *K* buys a new machine (Machine #1) and then leases it to *L* for use in *L*'s trade or business. The lease between *K* and *L* for Machine #1 is a true lease for Federal income tax purposes. During 2018, *L* enters into a written binding contract with *K* to buy Machine #1 at its fair market value on May 15, 2018. *L* did not have any depreciable interest in Machine #1 before *L* acquired it on May 15, 2018. As a result, *L*'s acquisition of Machine #1 satisfies the used property acquisition requirements of paragraph (b)(3)(iii) of this section. Assuming all other requirements are met, *L*'s purchase price of Machine #1 qualifies for the additional first year depreciation deduction for *L* under this section.

(G) *Example 7.* The facts are the same as in *Example 6* of paragraph (b)(3)(vii)(F) of this section, except that *K* and *L* are related parties within the meaning of section 179(d)(2)(A) or (B) and §1.179-4(c). As a result, *L*'s acquisition of Machine #1 does not satisfy the used property acquisition requirements of paragraph (b)(3)(iii) of this section. Thus, Machine #1 is not eligible for the additional first year depreciation deduction for *L*.

(H) *Example 8.* The facts are the same as in *Example 6* of paragraph (b)(3)(vii)(F) of this section, except *L* incurred capital expenditures of \$5,000 to improve Machine #1 on September 5, 2017, and has a depreciable interest in such improvements. *L*'s purchase price of \$5,000 for the improvements to Machine #1 satisfies the original use requirement of §1.168(k)-1(b)(3)(i) and, assuming all other requirements are met, qualifies for the 50-percent additional first year depreciation deduction. Because *L* had a depreciable interest only in the improvements to Machine #1, *L*'s acquisition of Machine #1, excluding *L*'s improvements to such machine, satisfies the used property acquisition requirements of paragraph (b)(3)(iii) of this section. Assuming all other requirements are met, *L*'s unadjusted depreciable basis of Machine #1, excluding the amount of such unadjusted depreciable basis attributable to *L*'s improvements to Machine #1, qualifies for the additional first year depreciation deduction for *L* under this section.

(I) *Example 9.* During 2016, *M* and *N* purchased used equipment for use in their trades or businesses and each own a 50 percent interest in such equipment. Prior to this acquisition, *M* and *N* did not have any depreciable interest in the equipment. Assume this ownership arrangement is not a partnership. During 2018, *N* enters into a written binding contract with *M* to buy *M*'s interest in the equipment. Pursuant to paragraph (b)(3)(iii)(B)(2) of this section, *N* is not treated as using *M*'s interest in the equipment prior to *N*'s acquisition of *M*'s interest. As a result, *N*'s acquisition of *M*'s interest in the equipment satisfies the used property acquisition requirements of paragraph (b)(3)(iii) of this section. Assuming all other requirements are met, *N*'s purchase price of *M*'s interest in the equipment qualifies for the additional first year depreciation deduction for *N* under this section.

(J) *Example 10.* The facts are the same as in *Example 9* of paragraph (b)(3)(vii)(I) of this section, except *N* had a 100-percent depreciable interest in the equipment during 2011 through 2015, and *M* purchased from *N* a 50-percent interest in the equipment during 2016. Pursuant to paragraph (b)(3)(iii)(B)(1) of this section, the lookback period is 2013 through 2017 to determine if *N* had a depreciable interest in *M*'s 50-percent interest in the equipment *N* acquired from *M* in 2018. Because *N* had a 100-percent depreciable interest in the equipment during 2013 through 2015, *N* had a depreciable interest in *M*'s 50-percent interest in the equipment during the lookback period. As a result, *N*'s acquisition of *M*'s interest in the equipment during 2018 does not satisfy the used property acquisition requirements of paragraphs (b)(3)(iii)(A)(1) and (b)(3)(iii)(B)(1) of this section. Paragraph (b)(3)(iii)(B)(2) of this section does not apply because *N* initially acquired a 100-percent depreciable interest in the equipment. Accordingly, *N*'s purchase price of *M*'s interest in the equipment during 2018 does not qualify for the additional first year depreciation deduction for *N*.

(K) *Example 11.* The facts are the same as in *Example 9* of paragraph (b)(3)(vii)(I) of this section, except *N* had a 100-percent depreciable interest in the equipment only during 2011, and *M* purchased from *N* a 50-percent interest in the equipment during 2012. Pursuant to paragraph (b)(3)(iii)(B)(1) of this section, the lookback period is 2013 through 2017 to determine if *N* had a depreciable interest in *M*'s 50-percent interest in the equipment *N* acquired from *M* in 2018. Because *N* had a depreciable interest in only its 50-percent interest in the equipment during this lookback period, *N*'s acquisition of *M*'s interest in the equipment during 2018 satisfies the used property acquisition requirements of paragraphs (b)(3)(iii)(A)(1) and (b)(3)(iii)(B)(1) of this section. Assuming all other requirements are met, *N*'s purchase price of *M*'s interest in the equipment during 2018 qualifies for the additional first year depreciation deduction for *N* under this section.

(L) *Example 12.* The facts are the same as in *Example 9* of paragraph (b)(3)(vii)(I) of this section, except during 2018, *M* also enters into a written binding contract with *N* to buy *N*'s interest in the equipment. Pursuant to paragraph (b)(3)(iii)(B)(2) of this section, both *M* and *N* are treated as previously having a depreciable interest in a 50-percent portion of the equipment. Accordingly, the acquisition by *M* of *N*'s 50-percent interest and the acquisition by *N* of *M*'s 50-percent interest in the equipment during 2018 do not qualify for the additional first year depreciation deduction.

(M) *Example 13.* *O* and *P* form an equal partnership, *OP*, in 2018. *O* contributes cash to *OP*, and *P* contributes equipment to *OP*. *OP*'s basis in the equipment contributed by *P* is determined under section 723. Because *OP*'s basis in such equipment is determined in whole or in part by reference to *P*'s adjusted basis in such equipment, *OP*'s acquisition of such equipment does not satisfy section 179(d)(2)(C) and §1.179-4(c)(1)(iv) and, thus, does not satisfy the used property acquisition requirements of paragraph (b)(3)(iii) of this section. Accordingly, *OP*'s acquisition of such equipment is not eligible for the additional first year depreciation deduction.

(N) *Example 14.* Q, R, and S form an equal partnership, QRS, in 2019. Each partner contributes \$100, which QRS uses to purchase a retail motor fuels outlet for \$300. Assume this retail motor fuels outlet is QRS' only property and is qualified property under section 168(k)(2)(A)(i). QRS makes an election not to deduct the additional first year depreciation for all qualified property placed in service during 2019. QRS has a section 754 election in effect. QRS claimed depreciation of \$15 for the retail motor fuels outlet for 2019. During 2020, when the retail motor fuels outlet's fair market value is \$600, Q sells all of its partnership interest to T in a fully taxable transaction for \$200. T never previously had a depreciable interest in the retail motor fuels outlet. T takes an outside basis of \$200 in the partnership interest previously owned by Q. T's share of the partnership's previously taxed capital is \$95. Accordingly, T's section 743(b) adjustment is \$105 and is allocated entirely to the retail motor fuels outlet under section 755. Assuming all other requirements are met, T's section 743(b) adjustment qualifies for the additional first year depreciation deduction under this section.

(O) *Example 15.* The facts are the same as in *Example 14* of paragraph (b)(3)(vii)(N) of this section, except that Q sells his partnership interest to U, a related person within the meaning of section 179(d)(2)(A) or (B) and §1.179-4(c). U's section 743(b) adjustment does not qualify for the additional first year depreciation deduction.

(P) *Example 16.* The facts are the same as in *Example 14* of paragraph (b)(3)(vii)(N) of this section, except that Q dies and his partnership interest is transferred to V. V takes a basis in Q's partnership interest under section 1014. As a result, section 179(d)(2)(C)(ii) and §1.179-4(c)(1)(iv) are not satisfied, and V's section 743(b) adjustment does not qualify for the additional first year depreciation deduction.

(Q) *Example 17.* The facts are the same as in *Example 14* of paragraph (b)(3)(vii)(N) of this section, except that QRS purchased the retail motor fuels outlet from T prior to T purchasing Q's partnership interest in QRS. T had a depreciable interest in such retail motor fuels outlet. Because T had a depreciable interest in the retail motor fuels outlet before T acquired its interest in QRS, T's section 743(b) adjustment does not qualify for the additional first year depreciation deduction.

(R) *Example 18.* (1) W, a freight transportation company, acquires and places in service a used aircraft during 2019 (Airplane #1). Prior to this acquisition, W never had a depreciable interest in this aircraft. During September 2020, W enters into a written binding contract with a third party to renovate Airplane #1. The third party begins to renovate Airplane #1 in October 2020 and delivers the renovated aircraft (Airplane #2) to W in February 2021. To renovate Airplane #1, the third party used mostly new parts but also used parts from Airplane #1. The cost of the used parts is not more than 20 percent of the total cost of the renovated airplane, Airplane #2. W uses Airplane #2 in its trade or business.

(2) Although Airplane #2 contains used parts, the cost of the used parts is not more than 20 percent of the total cost of Airplane #2. As a result, Airplane #2 is not treated as reconditioned or rebuilt property, and W is considered the original user of Airplane #2,

pursuant to paragraph (b)(3)(ii)(A) of this section. Accordingly, assuming all other requirements are met, the amount paid or incurred by W for Airplane #2 qualifies for the additional first year depreciation deduction for W under this section.

(S) *Example 19.* (1) X, a freight transportation company, acquires and places in service a new aircraft in 2019 (Airplane #1). During 2022, X sells Airplane #1 to AB and AB uses Airplane #1 in its trade or business. Prior to this acquisition, AB never had a depreciable interest in Airplane #1. During January 2023, AB enters into a written binding contract with a third party to renovate Airplane #1. The third party begins to renovate Airplane #1 in February 2023 and delivers the renovated aircraft (Airplane #2) to AB in June 2023. To renovate Airplane #1, the third party used mostly new parts but also used parts from Airplane #1. The cost of the used parts is not more than 20 percent of the total cost of the renovated airplane, Airplane #2. AB uses Airplane #2 in its trade or business. During 2025, AB sells Airplane #2 to X and X uses Airplane #2 in its trade or business.

(2) With respect to X's purchase of Airplane #1 in 2019, X is the original user of this airplane pursuant to paragraph (b)(3)(ii)(A) of this section. Accordingly, assuming all other requirements are met, X's purchase price for Airplane #1 qualifies for the additional first year depreciation deduction for X under this section.

(3) Because AB never had a depreciable interest in Airplane #1 prior to its acquisition in 2022, the requirements of paragraphs (b)(3)(iii)(A)(1) and (b)(3)(ii)(B)(1) of this section are satisfied. Accordingly, assuming all other requirements are met, AB's purchase price for Airplane #1 qualifies for the additional first year depreciation deduction for AB under this section.

(4) Although Airplane #2 contains used parts, the cost of the used parts is not more than 20 percent of the total cost of Airplane #2. As a result, Airplane #2 is not treated as reconditioned or rebuilt property, and AB is considered the original user of Airplane #2, pursuant to paragraph (b)(3)(ii)(A) of this section. Accordingly, assuming all other requirements are met, the amount paid or incurred by AB for Airplane #2 qualifies for the additional first year depreciation deduction for AB under this section.

(5) With respect to X's purchase of Airplane #2 in 2025, Airplane #2 is substantially renovated property pursuant to paragraph (b)(3)(iii)(B)(3) of this section. Also, pursuant to paragraph (b)(3)(iii)(B)(3) of this section, X's depreciable interest in Airplane #1 is not taken into account for determining if X previously had a depreciable interest in Airplane #2 prior to its acquisition during 2025. As a result, Airplane #2 is not treated as used by X at any time before its acquisition of Airplane #2 in 2025 pursuant to paragraph (b)(3)(iii)(B)(3) of this section. Accordingly, assuming all other requirements are met, X's purchase price of Airplane #2 qualifies for the additional first year depreciation deduction for X under this section.

(T) *Example 20.* In November 2017, AA Corporation purchases a used drill press costing \$10,000 and is granted a trade-in allowance of \$2,000 on its old drill press. The used drill press is qualified property under section 168(k)(2)(A)(i). The old drill

press had a basis of \$1,200. Under sections 1012 and 1031(d), the basis of the used drill press is \$9,200 (\$1,200 basis of old drill press plus cash expended of \$8,000). Only \$8,000 of the basis of the used drill press satisfies the requirements of section 179(d)(3) and §1.179-4(d) and, thus, satisfies the used property acquisition requirement of paragraph (b)(3)(iii) of this section. The remaining \$1,200 of the basis of the used drill press does not satisfy the requirements of section 179(d)(3) and §1.179-4(d) because it is determined by reference to the old drill press. Accordingly, assuming all other requirements are met, only \$8,000 of the basis of the used drill press is eligible for the additional first year depreciation deduction under this section.

(U) *Example 21.* (1) M Corporation acquires and places in service a used airplane on March 26, 2018. Prior to this acquisition, M Corporation never had a depreciable interest in this airplane. On March 26, 2018, M Corporation also leases the used airplane to N Corporation, an airline company. On May 27, 2018, M Corporation sells to O Corporation the used airplane subject to the lease with N Corporation. M Corporation and O Corporation are related parties within the meaning of section 179(d)(2)(A) or (B) and §1.179-4(c). As of May 27, 2018, N Corporation is still the lessee of the used airplane. Prior to this acquisition, O Corporation never had a depreciable interest in the used airplane. O Corporation is a calendar-year taxpayer.

(2) The sale transaction of May 27, 2018, satisfies the requirements of a syndication transaction described in paragraph (b)(3)(vi) of this section. As a result, O Corporation is considered the taxpayer that acquired the used airplane for purposes of applying the used property acquisition requirements in paragraph (b)(3)(iii) of this section. In applying these rules, the fact that M Corporation and O Corporation are related parties is not taken into account because O Corporation, not M Corporation, is treated as acquiring the used airplane. Also, O Corporation, not M Corporation, is treated as having the depreciable interest in the used airplane. Further, pursuant to paragraph (b)(4)(iv) of this section, the used airplane is treated as originally placed in service by O Corporation on May 27, 2018. Because O Corporation never had a depreciable interest in the used airplane and assuming all other requirements are met, O Corporation's purchase price of the used airplane qualifies for the additional first year depreciation deduction for O Corporation under this section.

(V) *Example 22.* (1) The facts are the same as in *Example 21* of paragraph (b)(3)(vii)(U)(1) of this section. Additionally, on September 5, 2018, O Corporation sells to P Corporation the used airplane subject to the lease with N Corporation. Prior to this acquisition, P Corporation never had a depreciable interest in the used airplane.

(2) Because O Corporation, a calendar-year taxpayer, placed in service and disposed of the used airplane during 2018, the used airplane is not eligible for the additional first year depreciation deduction for O Corporation pursuant to paragraph (g)(1)(i) of this section.

(3) Because P Corporation never had a depreciable interest in the used airplane and assuming all other requirements are met, P Corporation's purchase price of the used airplane qualifies for the additional

first year depreciation deduction for P Corporation under this section.

(W) *Example 23.* (1) The facts are the same as in *Example 21* of paragraph (b)(3)(vii)(U)(7) of this section, except M Corporation and O Corporation are not related parties within the meaning of section 179(d)(2)(A) or (B) and §1.179-4(c). Additionally, on March 26, 2020, O Corporation sells to M Corporation the used airplane subject to the lease with N Corporation.

(2) The sale transaction of May 27, 2018, satisfies the requirements of a syndication transaction described in paragraph (b)(3)(vi) of this section. As a result, O Corporation is considered the taxpayer that acquired the used airplane for purposes of applying the used property acquisition requirements in paragraph (b)(3)(iii) of this section. Also, O Corporation, not M Corporation, is treated as having the depreciable interest in the used airplane. Further, pursuant to paragraph (b)(4)(iv) of this section, the used airplane is treated as originally placed in service by O Corporation on May 27, 2018. Because O Corporation never had a depreciable interest in the used airplane before its acquisition in 2018 and assuming all other requirements are met, O Corporation's purchase price of the used airplane qualifies for the additional first year depreciation deduction for O Corporation under this section.

(3) Prior to its acquisition of the used airplane on March 26, 2020, M Corporation never had a depreciable interest in the used airplane pursuant to paragraph (b)(3)(vi) of this section. Assuming all other requirements are met, M Corporation's purchase price of the used airplane on March 26, 2020, qualifies for the additional first year depreciation deduction for M Corporation under this section.

(X) *Example 24.* (1) J, K, and L are corporations that are unrelated parties within the meaning of section 179(d)(2)(A) or (B) and §1.179-4(c). None of J, K, or L is a member of a consolidated group. J has a depreciable interest in Equipment #5. During 2018, J sells Equipment #5 to K. During 2020, J merges into L in a transaction described in section 368(a)(1)(A). In 2021, L acquires Equipment #5 from K.

(2) Because J is the predecessor of L, and because J previously had a depreciable interest in Equipment #5, L's acquisition of Equipment #5 does not satisfy paragraphs (b)(3)(iii)(A)(1) and (b)(3)(iii)(B)(1) of this section. Thus, L's acquisition of Equipment #5 does not satisfy the used property acquisition requirements of paragraph (b)(3)(iii) of this section. Accordingly, L's acquisition of Equipment #5 is not eligible for the additional first year depreciation deduction.

(4) *Placed-in-service date—(i) In general.* Depreciable property will meet the requirements of this paragraph (b)(4) if the property is placed in service by the taxpayer for use in its trade or business or for production of income after September 27, 2017; and, except as provided in paragraphs (b)(2)(i)(A) and (D) of this section, before January 1, 2027, or, in the case of property described in section 168(k)(2)(B) or (C), before January 1, 2028.

(ii) *Specified plant.* If the taxpayer has properly made an election to apply section 168(k)(5) for a specified plant, the requirements of this paragraph (b)(4) are satisfied only if the specified plant is planted before January 1, 2027, or is grafted before January 1, 2027, to a plant that has already been planted, by the taxpayer in the ordinary course of the taxpayer's farming business, as defined in section 263A(e)(4).

(iii) *Qualified film, television, or live theatrical production—(A) Qualified film or television production.* For purposes of this paragraph (b)(4), a qualified film or television production is treated as placed in service at the time of initial release or broadcast as defined under §1.181-1(a)(7). The taxpayer that places in service a qualified film or television production must be the owner, as defined in §1.181-1(a)(2), of the qualified film or television production.

(B) *Qualified live theatrical production.* For purposes of this paragraph (b)(4), a qualified live theatrical production is treated as placed in service at the time of the initial live staged performance. The taxpayer that places in service a qualified live theatrical production must be the owner, as defined in paragraph (b)(2)(i)(F) of this section and in §1.181-1(a)(2), of the qualified live theatrical production.

(iv) *Syndication transaction.* If new property is acquired and placed in service by a lessor, or if used property is acquired and placed in service by a lessor and the lessor and any predecessor did not previously have a depreciable interest in the used property, and the property 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 for purposes of sec-

tions 167 and 168, and §§1.46-3(d) and 1.167(a)-11(e)(1).

(v) *Technical termination of a partnership.* For purposes of this paragraph (b)(4), in the case of a technical termination of a partnership under section 708(b)(1)(B) occurring in a taxable year beginning before January 1, 2018, qualified 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 is contributed by the terminated partnership to the new partnership.

(vi) *Section 168(i)(7) transactions.* For purposes of this paragraph (b)(4), if qualified property is transferred in a transaction described in section 168(i)(7) in the same taxable year that the qualified 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. In the case of multiple transfers of qualified 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.

(5) *Acquisition of property—(i) In general.* This paragraph (b)(5) provides rules for the acquisition requirements in section 13201(h) of the Act. These rules apply to all property, including self-constructed property or property described in section 168(k)(2)(B) or (C).

(ii) *Acquisition date—(A) In general.* Except as provided in paragraph (b)(5)(vi) of this section, depreciable property will meet the requirements of this paragraph (b)(5) if the property is acquired by the taxpayer after September 27, 2017, or is acquired by the taxpayer pursuant to a written binding contract entered into by the taxpayer after September 27, 2017. Property that is manufactured, constructed, or produced for the taxpayer by another person under a written binding contract 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 not acquired pursuant to a written binding contract but is considered to be self-constructed property under this

paragraph (b)(5). For determination of acquisition date, see paragraph (b)(5)(ii)(B) of this section for property acquired pursuant to a written binding contract and paragraph (b)(5)(iv) of this section for self-constructed property.

(B) *Determination of acquisition date for property acquired pursuant to a written binding contract.* Except as provided in paragraphs (b)(5)(vi) and (vii) of this section, the acquisition date of property that the taxpayer acquired pursuant to a written binding contract is the later of—

(1) The date on which the contract was entered into;

(2) The date on which the contract is enforceable under State law;

(3) If the contract has one or more cancellation periods, the date on which all cancellation periods end. For purposes of this paragraph (b)(5)(ii)(B)(3), a cancellation period is the number of days stated in the contract for any party to cancel the contract without penalty; or

(4) If the contract has one or more contingency clauses, the date on which all conditions subject to such clauses are satisfied. For purposes of this paragraph (b)(5)(ii)(B)(4), a contingency clause is one that provides for a condition (or conditions) or action (or actions) that is within the control of any party or a predecessor.

(iii) *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, any 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. If a contract has multiple provisions that limit damages, only the provision with the highest damages is taken into account in determining whether the contract limits damages. Also, 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 did not contain a provision for liquidated damages, the contract is con-

sidered 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 if 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) *Letter of intent.* A letter of intent for an acquisition is not a binding contract.

(E) *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.

(F) *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)(5), the component does not qualify for the additional first year depreciation deduction under this section.

(G) [Reserved]

(iv) *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)(5)(ii) of this

section are treated as met for the property if the taxpayer begins manufacturing, constructing, or producing the property after September 27, 2017. Property that is manufactured, constructed, or produced for the taxpayer by another person under a written binding contract, as defined in paragraph (b)(5)(iii) 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)(5)(iii) of this section, before September 28, 2017, with another person to manufacture, construct, or produce property and the manufacture, construction, or production of this property begins after September 27, 2017, the acquisition rules in paragraph (b)(5)(ii) of this section are met.

(B) *When does manufacture, construction, or production begin—*
(1) *In general.* For purposes of paragraph (b)(5)(iv)(A) 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 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 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)(5)(iv)(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) (5)(iv)(B)(2). Physical work of a significant nature will be considered to begin at the time 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)(5)(iv)(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)(5)(iv)(B)(2) by filing a Federal 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)(5)(iv)(B)(2).

(C) *Components of self-constructed property—(I) Acquired components.* If a binding contract, as defined in paragraph (b)(5)(iii) of this section, to acquire a component does not satisfy the requirements of paragraph (b)(5)(ii) of this section, the component does not qualify for the additional first year depreciation deduction under this section. A binding contract described in the preceding sentence 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)(5)(iv)(A) of this section. Accordingly, the unadjusted depreciable basis of the larger self-constructed property that is eligible for the additional first year depreciation deduction under this section, 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)(5)(ii) of this section. If the manufacture, construction, or production of the larger self-constructed property begins before September 28, 2017, the larger self-constructed property and any acquired components related to the larger self-constructed property do not qualify for the additional first year depreciation deduction under this section. If a binding contract to acquire the component is entered into after September 27, 2017, but the manufacture, construction, or production of the larger self-constructed property does not begin before January 1, 2027, the component qualifies for the additional first year depreciation deduction under this section, 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 this paragraph (b)(5)(iv), the component does not qualify for the additional first year depreciation deduction under this section. However, if the manufacture, construction, or production of a component does not satisfy the requirements of this paragraph (b)(5)(iv), but the manufacture, construction, or production of the larger self-constructed property satisfies the requirements of this paragraph (b)(5)(iv), the larger self-constructed property qualifies for the additional first year depreciation deduction under this section, assuming all other requirements are met, even though the component does not qualify for the additional first year depreciation deduction under this section. Accordingly, the unadjusted depreciable basis of the larger self-constructed property that is eligible for the additional first year depreciation deduction under this section, assuming all other requirements are met, must not include the unadjusted depreciable basis of any component that does not qualify for the additional first year depreciation deduction under this section. If the manufacture, construction, or production of the larger self-constructed property began before September 28, 2017, the larger self-constructed property and any self-constructed components related to the larger self-constructed property do not qualify for the additional first year depreciation deduction under this section. If the manufacture, construction,

or production of a component begins after September 27, 2017, but the manufacture, construction, or production of the larger self-constructed property does not begin before January 1, 2027, the component qualifies for the additional first year depreciation deduction under this section, assuming all other requirements are met, but the larger self-constructed property does not.

(v) [Reserved]

(vi) *Qualified film, television, or live theatrical production—(A) Qualified film or television production.* For purposes of section 13201(h)(1)(A) of the Act, a qualified film or television production is treated as acquired on the date principal photography commences.

(B) *Qualified live theatrical production.* For purposes of section 13201(h)(1)(A) of the Act, a qualified live theatrical production is treated as acquired on the date when all of the necessary elements for producing the live theatrical production are secured. These elements may include a script, financing, actors, set, scenic and costume designs, advertising agents, music, and lighting.

(vii) *Specified plant.* If the taxpayer has properly made an election to apply section 168(k)(5) for a specified plant, the requirements of this paragraph (b)(5) are satisfied if the specified plant is planted after September 27, 2017, or is grafted after September 27, 2017, to a plant that has already been planted, by the taxpayer in the ordinary course of the taxpayer's farming business, as defined in section 263A(e)(4).

(viii) *Examples.* The application of this paragraph (b)(5) is illustrated by the following examples. Unless the facts specifically indicate otherwise, assume that the parties are not related within the meaning of section 179(d)(2)(A) or (B) and §1.179-4(c), and the parties do not have predecessors:

(A) *Example 1.* On September 1, 2017, BB, a corporation, entered into a written agreement with CC, 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)(5)(iii)(E) of this section.

(B) *Example 2.* The facts are the same as in *Example 1* of paragraph (b)(5)(viii)(A) of this section. On December 1, 2017, BB placed a purchase order with CC 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 *BB* with *CC* on December 1, 2017, is a binding contract pursuant to paragraph (b)(5)(iii)(E) of this section. Accordingly, assuming all other requirements are met, the cost of the 20 lamps qualifies for the 100-percent additional first year depreciation deduction.

(C) *Example 3.* The facts are the same as in *Example 1* of paragraph (b)(5)(viii)(A) of this section, except that the written agreement between *BB* and *CC* 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)(5)(iii)(E) of this section. However, because the agreement was entered into before September 28, 2017, no lamp acquired by *BB* under this contract qualifies for the 100-percent additional first year depreciation deduction.

(D) *Example 4.* On September 1, 2017, *DD* began constructing a retail motor fuels outlet for its own use. On November 1, 2018, *DD* ceases construction of the retail motor fuels outlet prior to its completion. Between September 1, 2017, and November 1, 2018, *DD* incurred \$3,000,000 of expenditures for the construction of the retail motor fuels outlet. On May 1, 2019, *DD* resumed construction of the retail motor fuels outlet and completed its construction on August 31, 2019. Between May 1, 2019, and August 31, 2019, *DD* incurred another \$1,600,000 of expenditures to complete the construction of the retail motor fuels outlet and, on September 1, 2019, *DD* placed the retail motor fuels outlet in service. None of *DD*'s total expenditures of \$4,600,000 qualify for the 100-percent additional first year depreciation deduction because, pursuant to paragraph (b)(5)(iv)(A) of this section, *DD* began constructing the retail motor fuels outlet before September 28, 2017.

(E) *Example 5.* The facts are the same as in *Example 4* of paragraph (b)(5)(viii)(D) of this section except that *DD* began constructing the retail motor fuels outlet for its own use on October 1, 2017, and *DD* incurred the \$3,000,000 between October 1, 2017, and November 1, 2018. *DD*'s total expenditures of \$4,600,000 qualify for the 100-percent additional first year depreciation deduction because, pursuant to paragraph (b)(5)(iv)(A) of this section, *DD* began constructing the retail motor fuels outlet after September 27, 2017, and *DD* placed the retail motor fuels outlet in service on September 1, 2019. Accordingly, assuming all other requirements are met, the additional first year depreciation deduction for the retail motor fuels outlet will be \$4,600,000, computed as \$4,600,000 multiplied by 100 percent.

(F) *Example 6.* On August 15, 2017, *EE*, an accrual basis taxpayer, entered into a written binding contract with *FF* to manufacture an aircraft described in section 168(k)(2)(C) for use in *EE*'s trade or business. *FF* begins to manufacture the aircraft on October 1, 2017. The completed aircraft is delivered to *EE* on February 15, 2018, at which time *EE* incurred the total cost of the aircraft. *EE* places the aircraft in service on March 1, 2018. Pursuant to paragraphs (b)(5)(ii)(A) and (b)(5)(iv)(A) of this section, the aircraft is considered to be manufactured

by *EE*. Because *EE* began manufacturing the aircraft after September 27, 2017, the aircraft qualifies for the 100-percent additional first year depreciation deduction, assuming all other requirements are met.

(G) *Example 7.* On June 1, 2017, *HH* entered into a written binding contract with *GG* to acquire a new component part of property that is being constructed by *HH* for its own use in its trade or business. *HH* commenced construction of the property in November 2017, and placed the property in service in November 2018. Because *HH* entered into a written binding contract to acquire a component part prior to September 28, 2017, pursuant to paragraphs (b)(5)(ii) and (b)(5)(iv)(C)(I) of this section, the component part does not qualify for the 100-percent additional first year depreciation deduction. However, pursuant to paragraphs (b)(5)(iv)(A) and (b)(5)(iv)(C)(I) of this section, the property constructed by *HH* will qualify for the 100-percent additional first year depreciation deduction, because construction of the property began after September 27, 2017, assuming all other requirements are met. Accordingly, the unadjusted depreciable basis of the property that is eligible for the 100-percent additional first year depreciation deduction must not include the unadjusted depreciable basis of the component part.

(H) *Example 8.* The facts are the same as in *Example 7* of paragraph (b)(5)(viii)(G) of this section except that *HH* entered into the written binding contract with *GG* to acquire the new component part on September 30, 2017, and *HH* commenced construction of the property on August 1, 2017. Pursuant to paragraphs (b)(5)(iv)(A) and (C) of this section, neither the property constructed by *HH* nor the component part will qualify for the 100-percent additional first year depreciation deduction, because *HH* began construction of the property prior to September 28, 2017.

(I) *Example 9.* On September 1, 2017, *II* acquired and placed in service equipment. On January 15, 2018, *II* sells the equipment to *JJ* and leases the property back from *JJ* in a sale-leaseback transaction. Pursuant to paragraph (b)(5)(ii) of this section, *II*'s cost of the equipment does not qualify for the 100-percent additional first year depreciation deduction because *II* acquired the equipment prior to September 28, 2017. However, *JJ* acquired used equipment from an unrelated party after September 27, 2017, and, assuming all other requirements are met, *JJ*'s cost of the used equipment qualifies for the 100-percent additional first year depreciation deduction for *JJ*.

(J) *Example 10.* On July 1, 2017, *KK* began constructing property for its own use in its trade or business. *KK* placed this property in service on September 15, 2017. On January 15, 2018, *KK* sells the property to *LL* and leases the property back from *LL* in a sale-leaseback transaction. Pursuant to paragraph (b)(5)(iv) of this section, *KK*'s cost of the property does not qualify for the 100-percent additional first year depreciation deduction because *KK* began construction of the property prior to September 28, 2017. However, *LL* acquired used property from an unrelated party after September 27, 2017, and, assuming all other requirements are met, *LL*'s cost of the used property qualifies for the 100-percent additional first year depreciation deduction for *LL*.

(K) *Example 11.* *MM*, a calendar year taxpayer, is engaged in a trade or business described in section 163(j)(7)(A)(iv). In December 2018, *MM* began constructing a new electric generation power plant for its own use. *MM* placed in service this new power plant, including all component parts, in 2020. Even though *MM* began constructing the power plant after September 27, 2017, none of *MM*'s total expenditures of the power plant qualify for the additional first year depreciation deduction under this section because, pursuant to paragraph (b)(2)(ii)(F) of this section, the power plant is property that is primarily used in a trade or business described in section 163(j)(7)(A)(iv) and the power plant was placed in service in *MM*'s taxable year beginning after 2017.

(c) [Reserved]

(d) *Property described in section 168(k)(2)(B) or (C)—(1) In general.* Property described in section 168(k)(2)(B) or (C) will meet the acquisition requirements of section 168(k)(2)(B)(i)(III) or (k)(2)(C)(i) if the property is acquired by the taxpayer before January 1, 2027, or acquired by the taxpayer pursuant to a written binding contract that is entered into before January 1, 2027. Property described in section 168(k)(2)(B) or (C), including its components, also must meet the acquisition requirement in section 13201(h)(1)(A) of the Act (for further guidance, see paragraph (b)(5) of this section).

(2) *Definition of binding contract.* For purposes of this paragraph (d), the rules in paragraph (b)(5)(iii) of this section for a binding contract apply.

(3) *Self-constructed property—(i) 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 (d)(1) of this section are treated as met for the property if the taxpayer begins manufacturing, constructing, or producing the property before January 1, 2027. Property that is manufactured, constructed, or produced for the taxpayer by another person under a written binding contract, as defined in paragraph (b)(5)(iii) 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)(5)(iii) of this section, before January 1, 2027, with another person to manufacture, construct, or produce

property described in section 168(k)(2)(B) or (C) and the manufacture, construction, or production of this property begins after December 31, 2026, the acquisition rule in paragraph (d)(1) of this section is met.

(ii) *When does manufacture, construction, or production begin*—(A) *In general*. For purposes of this paragraph (d)(3), 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 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 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.

(B) *Safe harbor*. For purposes of paragraph (d)(3)(ii)(A) of this section, a taxpayer may choose to determine when physical work of a significant nature begins in accordance with this paragraph (d)(3)(ii)(B). Physical work of a significant nature will be considered to begin at the time 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 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 (d)(3)(ii)(B) 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 (d)(3)(ii)(B) by filing a Federal 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 (d)(3)(ii)(B).

(iii) *Components of self-constructed property*—(A) *Acquired components*. If a binding contract, as defined in paragraph (b)(5)(iii) of this section, to acquire a component does not satisfy the requirements of paragraph (d)(1) of this section, the component does not qualify for the additional first year depreciation deduction under this section. A binding contract described in the preceding sentence 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 (d)(3)(i) of this section. Accordingly, the unadjusted depreciable basis of the larger self-constructed property that is eligible for the additional first year depreciation deduction under this section, assuming all other requirements are met, must not include the unadjusted depreciable basis of any component that does not satisfy the requirements of paragraph (d)(1) of this section. If a binding contract to acquire the component is entered into before January 1, 2027, but the manufacture, construction, or production of the larger self-constructed property does not begin before January 1, 2027, the component qualifies for the additional first year depreciation deduction under this section, assuming all other requirements are met, but the larger self-constructed property does not.

(B) *Self-constructed components*. If the manufacture, construction, or production of a component by the taxpayer does not satisfy the requirements of paragraph (d)(3)(i) of this section, the component does not qualify for the additional first year depreciation deduction under this section. However, if the manufacture, construc-

tion, or production of a component does not satisfy the requirements of paragraph (d)(3)(i) of this section, but the manufacture, construction, or production of the larger self-constructed property satisfies the requirements of paragraph (d)(3)(i) of this section, the larger self-constructed property qualifies for the additional first year depreciation deduction under this section, assuming all other requirements are met, even though the component does not qualify for the additional first year depreciation deduction under this section. Accordingly, the unadjusted depreciable basis of the larger self-constructed property that is eligible for the additional first year depreciation deduction under this section, assuming all other requirements are met, must not include the unadjusted depreciable basis of any component that does not qualify for the additional first year depreciation deduction under this section. If the manufacture, construction, or production of a component begins before January 1, 2027, but the manufacture, construction, or production of the larger self-constructed property does not begin before January 1, 2027, the component qualifies for the additional first year depreciation deduction under this section, assuming all other requirements are met, but the larger self-constructed property does not.

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

(A) *Example 1. (1)* On June 1, 2016, *NN* 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 *NN*. On August 15, 2016, *NN* entered into a written binding contract with *OO* to acquire this component part of the property for \$100,000. *OO* began manufacturing the component part on November 1, 2016, and delivered the completed component part to *NN* on September 1, 2017, at which time *NN* incurred \$100,000 for the cost of the component. The cost of this component part is 9 percent of the total cost of the property to be constructed by *NN*. *NN* did not incur any other cost of the property to be constructed before *NN* began construction. *NN* began constructing the property described in section 168(k)(2)(B) on October 15, 2017, and placed in service this property, including all component parts, on November 1, 2020. *NN* uses the safe harbor test in paragraph (d)(3)(ii)(B) of this section to determine when physical work of a significant nature begins for the property described in section 168(k)(2)(B).

(2) Because the component part of \$100,000 that was manufactured by *OO* for *NN* is not more than 10 percent of the total cost of the property described in

section 168(k)(2)(B), physical work of a significant nature for the property described in section 168(k)(2)(B) did not begin before September 28, 2017.

(3) Pursuant to paragraphs (b)(5)(iv)(C)(2) and (d)(1) of this section, the self-constructed component part of \$100,000 manufactured by *OO* for *NN* is not eligible for the 100-percent additional first year depreciation deduction because the manufacturing of such component part began before September 28, 2017. However, pursuant to paragraph (d)(3)(i) of this section, the cost of the property described in section 168(k)(2)(B), excluding the cost of the component part of \$100,000 manufactured by *OO* for *NN*, is eligible for the 100-percent additional first year depreciation deduction, assuming all other requirements are met, because construction of the property began after September 27, 2017, and before January 1, 2027, and the property described in section 168(k)(2)(B) was placed in service by *NN* during 2020.

(B) *Example 2.* (1) On June 1, 2026, *PP* 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 *PP*. On August 15, 2026, *PP* entered into a written binding contract with *XP* to acquire this component part of the property for \$100,000. *XP* began manufacturing the component part on September 1, 2026, and delivered the completed component part to *PP* on February 1, 2027, at which time *PP* incurred \$100,000 for the cost of the component. The cost of this component part is 9 percent of the total cost of the property to be constructed by *PP*. *PP* did not incur any other cost of the property to be constructed before *PP* began construction. *PP* began constructing the property described in section 168(k)(2)(B) on January 15, 2027, and placed this property, including all component parts, in service on November 1, 2027.

(2) Pursuant to paragraph (d)(3)(iii)(B) of this section, the self-constructed component part of \$100,000 manufactured by *XP* for *PP* is eligible for the additional first year depreciation deduction under this section, assuming all other requirements are met, because the manufacturing of the component part began before January 1, 2027, and the property described in section 168(k)(2)(B), the larger self-constructed property, was placed in service by *PP* before January 1, 2028. However, pursuant to paragraph (d)(3)(i) 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 *XP* for *PP*, is not eligible for the additional first year depreciation deduction under this section because construction of the property began after December 31, 2026.

(C) *Example 3.* On December 1, 2026, *QQ* entered into a written binding contract, as defined in paragraph (b)(5)(iii) of this section, with *RR* to manufacture an aircraft described in section 168(k)(2)(C) for use in *QQ*'s trade or business. *RR* begins to manufacture the aircraft on February 1, 2027. *QQ* places the aircraft in service on August 1, 2027. Pursuant to paragraph (d)(3)(i) of this section, the aircraft meets the requirements of paragraph (d)(1) of this section because the aircraft was acquired by *QQ* pursuant to a written binding contract entered into before January 1, 2027. Further, the aircraft was placed in service by *QQ* before January 1, 2028. Thus, assum-

ing all other requirements are met, *QQ*'s cost of the aircraft is eligible for the additional first year depreciation deduction under this section.

(e) *Computation of depreciation deduction for qualified property—(1) Additional first year depreciation deduction—*(i) *Allowable taxable year.* The additional first year depreciation deduction is allowable—

(A) Except as provided in paragraph (e)(1)(i)(B) or (g) of this section, in the taxable year in which the qualified property is placed in service by the taxpayer for use in its trade or business or for the production of income; or

(B) In the taxable year in which the specified plant is planted, or grafted to a plant that has already been planted, by the taxpayer in the ordinary course of the taxpayer's farming business, as defined in section 263A(e)(4), if the taxpayer properly made the election to apply section 168(k)(5) (for further guidance, see paragraph (f) of this section).

(ii) *Computation.* Except as provided in paragraph (g)(5) of this section, the allowable additional first year depreciation deduction for qualified property is determined by multiplying the unadjusted depreciable basis, as defined in §1.168(b)-1(a)(3), of the qualified property by the applicable percentage. Except as provided in paragraph (g)(1) of this section, the additional first year depreciation deduction is not affected by a taxable year of less than 12 months. See paragraph (g)(1) of this section for qualified property placed in service or planted or grafted, as applicable, and disposed of during the same taxable year. See paragraph (g)(5) of this section for qualified property acquired in a like-kind exchange or as a result of an involuntary conversion.

(iii) *Property described in section 168(k)(2)(B).* For purposes of paragraph (e)(1)(ii) of this section, the unadjusted depreciable basis, as defined in §1.168(b)-1(a)(3), of qualified property described in section 168(k)(2)(B) is limited to the property's unadjusted depreciable basis attributable to the property's manufacture, construction, or production before January 1, 2027.

(iv) *Alternative minimum tax—(A) In general.* The additional first year depreciation deduction is allowable for alternative minimum tax purposes—

(I) Except as provided in paragraph (e)(1)(iv)(A)(2) of this section, in the taxable year in which the qualified property is placed in service by the taxpayer; or

(2) In the taxable year in which a specified plant is planted by the taxpayer, or grafted by the taxpayer to a plant that was previously planted, if the taxpayer properly made the election to apply section 168(k)(5) (for further guidance, see paragraph (f) of this section).

(B) *Special rules.* In general, the additional first year depreciation deduction for alternative minimum tax purposes is based on the unadjusted depreciable basis of the property for alternative minimum tax purposes. However, see paragraph (g)(5)(iii)(E) of this section for qualified property acquired in a like-kind exchange or as a result of an involuntary conversion.

(2) *Otherwise allowable depreciation deduction—(i) In general.* Before determining the amount otherwise allowable as a depreciation deduction for the qualified property for the placed-in-service year and any subsequent taxable year, the taxpayer must determine the remaining adjusted depreciable basis of the qualified property. This remaining adjusted depreciable basis is equal to the unadjusted depreciable basis, as defined in §1.168(b)-1(a)(3), of the qualified property reduced by the amount of the additional first year depreciation allowed or allowable, whichever is greater. The remaining adjusted depreciable basis of the qualified property is then depreciated using the applicable depreciation provisions under the Internal Revenue Code for the qualified property. The remaining adjusted depreciable basis of the qualified property that is MACRS property is also the basis to which the annual depreciation rates in the optional depreciation tables apply (for further guidance, see section 8 of Rev. Proc. 87-57 (1987-2 C.B. 687) and §601.601(d)(2)(ii)(b) of this chapter). The depreciation deduction allowable for the remaining adjusted depreciable basis of the qualified property is affected by a taxable year of less than 12 months.

(ii) *Alternative minimum tax.* For alternative minimum tax purposes, the depreciation deduction allowable for the remaining adjusted depreciable basis of the qualified property is based on the remaining adjusted depreciable basis for alternative minimum tax purposes. The

remaining adjusted depreciable basis of the qualified property for alternative minimum tax purposes is depreciated using the same depreciation method, recovery period (or useful life in the case of computer software), and convention that apply to the qualified property for regular tax purposes.

(3) *Examples.* This paragraph (e) is illustrated by the following examples:

(i) *Example 1.* On March 1, 2023, *SS*, a calendar-year taxpayer, purchased and placed in service qualified property that costs \$1 million and is 5-year property under section 168(e). *SS* depreciates its 5-year property placed in service in 2023 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. For 2023, *SS* is allowed an 80-percent additional first year depreciation deduction of \$800,000 (the unadjusted depreciable basis of \$1 million multiplied by 0.80). Next, *SS* must reduce the unadjusted depreciable basis of \$1 million by the additional first year depreciation deduction of \$800,000 to determine the remaining adjusted depreciable basis of \$200,000. Then, *SS*' depreciation deduction allowable in 2023 for the remaining adjusted depreciable basis of \$200,000 is \$40,000 (the remaining adjusted depreciable basis of \$200,000 multiplied by the annual depreciation rate of 0.20 for recovery year 1).

(ii) *Example 2.* On June 1, 2023, *TT*, a calendar-year taxpayer, purchased and placed in service qualified property that costs \$1,500,000. The property qualifies for the expensing election under section 179 and is 5-year property under section 168(e). *TT* did not purchase any other section 179 property in 2023. *TT* makes the election under section 179 for the property and depreciates its 5-year property placed in service in 2023 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. Assume the maximum section 179 deduction for 2023 is \$1,000,000. For 2023, *TT* is first allowed a \$1,000,000 deduction under section 179. Next, *TT* must reduce the cost of \$1,500,000 by the section 179 deduction of \$1,000,000 to determine the unadjusted depreciable basis of \$500,000. Then, for 2023, *TT* is allowed an 80-percent additional first year depreciation deduction of \$400,000 (the unadjusted depreciable basis of \$500,000 multiplied by 0.80). Next, *TT* must reduce the unadjusted depreciable basis of \$500,000 by the additional first year depreciation deduction of \$400,000 to determine the remaining adjusted depreciable basis of \$100,000. Then, *TT*'s depreciation deduction allowable in 2023 for the remaining adjusted depreciable basis of \$100,000 is \$20,000 (the remaining adjusted depreciable basis of \$100,000 multiplied by the annual depreciation rate of 0.20 for recovery year 1).

(f) *Elections under section 168(k)—(1) Election not to deduct additional first year depreciation—(i) In general.* A taxpayer may make an election not to deduct the

additional first year depreciation for any class of property that is qualified property placed in service during the taxable year. If this election is made, the election applies to all qualified property that is in the same class of property and placed in service in the same taxable year, and no additional first year depreciation deduction is allowable for the property placed in service during the taxable year in the class of property, except as provided in §1.743-1(j)(4)(i)(B)(1).

(ii) *Definition of class of property.* For purposes of this paragraph (f)(1), the term *class of property* means:

(A) Except for the property described in paragraphs (f)(1)(ii)(B) and (D), and (f)(2) of this section, each class of property described in section 168(e) (for example, 5-year property);

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

(C) Computer software as defined in, and depreciated under, section 167(f)(1) and §1.167(a)-14(b);

(D) Qualified improvement property as defined in §1.168(b)-1(a)(5)(i)(C) and (a)(5)(ii), and depreciated under section 168;

(E) Each separate production, as defined in §1.181-3(b), of a qualified film or television production;

(F) Each separate production, as defined in section 181(e)(2), of a qualified live theatrical production; or

(G) A partner's basis adjustment in partnership assets under section 743(b) for each class of property described in paragraphs (f)(1)(ii)(A) through (F), and (f)(2) of this section (for further guidance, see §1.743-1(j)(4)(i)(B)(1)).

(iii) *Time and manner for making election—(A) Time for making election.* Except as provided in paragraph (f)(6) of this section, any election specified in paragraph (f)(1)(i) of this section must be made by the due date, including extensions, of the Federal tax return for the taxable year in which the qualified property is placed in service by the taxpayer.

(B) *Manner of making election.* Except as provided in paragraph (f)(6) of this section, any election specified in paragraph (f)(1)(i) of this section must be made in the manner prescribed on Form 4562, "Depreciation and Amortization," and its instructions. The election is made sepa-

rately by each person owning qualified property (for example, for each member of a consolidated group by the common parent of the group, by the partnership (including a lower-tier partnership; also including basis adjustments in the partnership assets under section 743(b)), or by the S corporation). If Form 4562 is revised or renumbered, any reference in this section to that form shall be treated as a reference to the revised or renumbered form.

(iv) *Failure to make election.* If a taxpayer does not make the election specified in paragraph (f)(1)(i) of this section within the time and in the manner prescribed in paragraph (f)(1)(iii) of this section, the amount of depreciation allowable for that property under section 167 or 168, as applicable, must be determined for the placed-in-service year and for all subsequent taxable years by taking into account the additional first year depreciation deduction. Thus, any election specified in paragraph (f)(1)(i) of this section shall not be made by the taxpayer in any other manner (for example, the election cannot be made through a request under section 446(e) to change the taxpayer's method of accounting).

(2) *Election to apply section 168(k)(5) for specified plants—(i) In general.* A taxpayer may make an election to apply section 168(k)(5) to one or more specified plants that are planted, or grafted to a plant that has already been planted, by the taxpayer in the ordinary course of the taxpayer's farming business, as defined in section 263A(e)(4). If this election is made for a specified plant, such plant is not treated as qualified property under section 168(k) and this section in its placed-in-service year.

(ii) *Time and manner for making election—(A) Time for making election.* Except as provided in paragraph (f)(6) of this section, any election specified in paragraph (f)(2)(i) of this section must be made by the due date, including extensions, of the Federal tax return for the taxable year in which the taxpayer planted or grafted the specified plant to which the election applies.

(B) *Manner of making election.* Except as provided in paragraph (f)(6) of this section, any election specified in paragraph (f)(2)(i) of this section must be made in the manner prescribed on Form 4562,

“Depreciation and Amortization,” and its instructions. The election is made separately by each person owning specified plants (for example, for each member of a consolidated group by the common parent of the group, by the partnership (including a lower-tier partnership), or by the S corporation). If Form 4562 is revised or renumbered, any reference in this section to that form shall be treated as a reference to the revised or renumbered form.

(iii) *Failure to make election.* If a taxpayer does not make the election specified in paragraph (f)(2)(i) of this section for a specified plant within the time and in the manner prescribed in paragraph (f)(2)(ii) of this section, the specified plant is treated as qualified property under section 168(k), assuming all requirements are met, in the taxable year in which such plant is placed in service by the taxpayer. Thus, any election specified in paragraph (f)(2)(i) of this section shall not be made by the taxpayer in any other manner (for example, the election cannot be made through a request under section 446(e) to change the taxpayer’s method of accounting).

(3) *Election for qualified property placed in service during the 2017 taxable year—(i) In general.* A taxpayer may make an election to deduct 50 percent, instead of 100 percent, additional first year depreciation for all qualified property acquired after September 27, 2017, by the taxpayer and placed in service by the taxpayer during its taxable year that includes September 28, 2017. If a taxpayer makes an election to apply section 168(k)(5) for its taxable year that includes September 28, 2017, the taxpayer also may make an election to deduct 50 percent, instead of 100 percent, additional first year depreciation for all specified plants that are planted, or grafted to a plant that has already been planted, after September 27, 2017, by the taxpayer in the ordinary course of the taxpayer’s farming business during such taxable year.

(ii) *Time and manner for making election—(A) Time for making election.* Except as provided in paragraph (f)(6) of this section, any election specified in paragraph (f)(3)(i) of this section must be made by the due date, including extensions, of the Federal tax return for the taxpayer’s taxable year that includes September 28, 2017.

(B) *Manner of making election.* Except as provided in paragraph (f)(6) of this section, any election specified in paragraph (f)(3)(i) of this section must be made in the manner prescribed on the 2017 Form 4562, “Depreciation and Amortization,” and its instructions. The election is made separately by each person owning qualified property (for example, for each member of a consolidated group by the common parent of the group, by the partnership (including a lower-tier partnership), or by the S corporation).

(iii) *Failure to make election.* If a taxpayer does not make the election specified in paragraph (f)(3)(i) of this section within the time and in the manner prescribed in paragraph (f)(3)(ii) of this section, the amount of depreciation allowable for qualified property under section 167 or 168, as applicable, acquired and placed in service, or planted or grafted, as applicable, by the taxpayer after September 27, 2017, must be determined for the taxable year that includes September 28, 2017, and for all subsequent taxable years by taking into account the 100-percent additional first year depreciation deduction, unless the taxpayer makes the election specified in paragraph (f)(1)(i) of this section within the time and in the manner prescribed in paragraph (f)(1)(iii) of this section for the class of property in which the qualified property is included. Thus, any election specified in paragraph (f)(3)(i) of this section shall not be made by the taxpayer in any other manner (for example, the election cannot be made through a request under section 446(e) to change the taxpayer’s method of accounting).

(4) *Alternative minimum tax.* If a taxpayer makes an election specified in paragraph (f)(1) of this section for a class of property or in paragraph (f)(2) of this section for a specified plant, the depreciation adjustments under section 56 and the regulations in this part under section 56 do not apply to the property or specified plant, as applicable, to which that election applies for purposes of computing the taxpayer’s alternative minimum taxable income. If a taxpayer makes an election specified in paragraph (f)(3) of this section for all qualified property, see paragraphs (e)(1)(iv) and (e)(2)(ii) of this section.

(5) *Revocation of election—(i) In general.* Except as provided in paragraphs (f)

(5)(ii) and (f)(6) of this section, an election specified in this paragraph (f), once made, may be revoked only by filing a request for a private letter ruling and obtaining the Commissioner of Internal Revenue’s written consent to revoke the election. The Commissioner may grant a request to revoke the election if the taxpayer acted reasonably and in good faith, and the revocation will not prejudice the interests of the Government. See generally §301.9100-3 of this chapter. An election specified in this paragraph (f) may not be revoked through a request under section 446(e) to change the taxpayer’s method of accounting.

(ii) *Automatic 6-month extension.* If a taxpayer made an election specified in this paragraph (f), an automatic extension of 6 months from the due date of the taxpayer’s Federal tax return, excluding extensions, for the placed-in-service year or the taxable year in which the specified plant is planted or grafted, as applicable, is granted to revoke that election, provided the taxpayer timely filed the taxpayer’s Federal tax return for the placed-in-service year or the taxable year in which the specified plant is planted or grafted, as applicable, and, within this 6-month extension period, the taxpayer, and all taxpayers whose tax liability would be affected by the election, file an amended Federal tax return for the placed-in-service year or the taxable year in which the specified plant is planted or grafted, as applicable, in a manner that is consistent with the revocation of the election.

(6) *Special rules for 2016 and 2017 returns.* For an election specified in this paragraph (f) for qualified property placed in service, or for a specified plant that is planted, or grafted to a plant that has already been planted, by the taxpayer during its taxable year that included September 28, 2017, the taxpayer should refer to Rev. Proc. 2019-33 (2019-34 I.R.B. 662) (see §601.601(d)(2)(ii)(b) of this chapter) for the time and manner of making the election on the 2016 or 2017 Federal tax return.

(g) *Special rules—(1) Property placed in service and disposed of in the same taxable year—(i) In general.* Except as provided in paragraphs (g)(1)(ii) and (iii) of this section, the additional first year depreciation deduction is not allowed for qual-

ified property placed in service or planted or grafted, as applicable, and disposed of during the same taxable year. If a partnership interest is acquired and disposed of during the same taxable year, the additional first year depreciation deduction is not allowed for any section 743(b) adjustment arising from the initial acquisition. Also, if qualified 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) in a taxable year beginning before January 1, 2018, the additional first year depreciation deduction is allowable for any qualified property placed in service or planted or grafted, as applicable, 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 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 was contributed by the terminated partnership to the new partnership. However, if qualified property is both placed in service or planted or grafted, as applicable, 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 is transferred in a transaction described in section 168(i)(7) in the same taxable year that the qualified property is placed in service or planted or grafted, as applicable, by the transferor, the additional first year depreciation deduction is allowable for the qualified property. If a partnership interest is purchased and transferred in a transaction

described in section 168(i)(7) in the same taxable year, the additional first year depreciation deduction is allowable for any section 743(b) adjustment that arises from the initial acquisition with respect to qualified property held by the partnership, provided the requirements of paragraph (b)(3)(iv)(D) of this section and all other requirements of section 168(k) and this section are satisfied. The allowable additional first year depreciation deduction for the qualified property for the transferor's taxable year in which the property is placed in service or planted or grafted, as applicable, is allocated between the transferor and the transferee on a monthly basis. The allowable additional first year depreciation deduction for a section 743(b) adjustment with respect to qualified property held by the partnership is allocated between the transferor and the transferee on a monthly basis notwithstanding that under §1.743-1(f) a transferee's section 743(b) adjustment is determined without regard to a transferors section 743(b) adjustment. These allocations 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, solely for purposes of this section, if the qualified property is transferred in a section 721(a) transaction to a partnership that has as a partner a person, other than the transferor, who previously had a depreciable interest in the qualified property, in the same taxable year that the qualified property is acquired or planted or grafted, as applicable, by the transferor, the qualified property is deemed to be placed in service or planted or grafted, as applicable, by the transferor during that taxable year, and the allowable additional first year depreciation deduction is allocated entirely to the transferor and not to the partnership. Additionally, if qualified property is both placed in service or planted or grafted, as applicable, 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 (g)(1) is illustrated by the following examples:

(A) *Example 1.* *UU* and *VV* are equal partners in *Partnership JL*, a general partnership. *Partnership JL* is a calendar-year taxpayer. On October 1, 2017, *Partnership JL* purchased and placed in service qualified property at a cost of \$30,000. On November 1, 2017, *UU* sells its entire 50 percent interest to *VV* in a transfer that terminates the partnership under section 708(b)(1)(B). As a result, terminated *Partnership JL* is deemed to have contributed the qualified property to new *Partnership JL*. Pursuant to paragraph (g)(1)(ii) of this section, new *Partnership JL*, not terminated *Partnership JL*, is eligible to claim the 100-percent additional first year depreciation deduction allowable for the qualified property for the taxable year 2017, assuming all other requirements are met.

(B) *Example 2.* On January 5, 2018, *XX* purchased and placed in service qualified property for a total amount of \$9,000. On August 20, 2018, *XX* transferred this qualified property to *Partnership BC* in a transaction described in section 721(a). No other partner of *Partnership BC* has ever had a depreciable interest in the qualified property. *XX* and *Partnership BC* are calendar-year taxpayers. Because the transaction between *XX* and *Partnership BC* is a transaction described in section 168(i)(7), pursuant to paragraph (g)(1)(iii) of this section, the 100-percent additional first year depreciation deduction allowable for the qualified property is allocated between *XX* 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 100-percent additional first year depreciation deduction allowable of \$9,000 for the qualified property for 2018 is allocated between *XX* and *Partnership BC* based on the number of months that *XX* and *Partnership BC* held the qualified property in service during 2018. Thus, because the qualified property was held in service by *XX* for 7 of 12 months, which includes the month in which *XX* placed the qualified property in service but does not include the month in which the qualified property was transferred, *XX* is allocated \$5,250 ($\frac{7}{12} \times \$9,000$ additional first year depreciation deduction). *Partnership BC* is allocated \$3,750, the remaining $\frac{5}{12}$ of the \$9,000 additional first year depreciation deduction allowable for the qualified property.

(2) *Redetermination of basis.* If the unadjusted depreciable basis, as defined in §1.168(b)-1(a)(3), of qualified property is redetermined (for example, due to contingent purchase price or discharge of indebtedness) before January 1, 2027, or in the case of property described in section 168(k)(2)(B) or (C), is redetermined before January 1, 2028, the additional first year depreciation deduction allowable for the qualified property is redetermined as follows:

(i) *Increase in basis.* For the taxable year in which an increase in basis of qualified 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 the applicable percentage for the taxable year in which the underlying property was placed in service by the taxpayer. For purposes of this paragraph (g)(2)(i), the additional first year depreciation deduction applies to the increase in basis only if the underlying property is qualified property. To determine the amount otherwise allowable as a depreciation deduction for the increase in basis of qualified property, the amount of the increase in basis of the qualified 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, except for computer software described in paragraph (b)(2)(i)(B) of this section, a qualified film or television production described in paragraph (b)(2)(i)(E) of this section, or a qualified live theatrical production described in paragraph (b)(2)(i)(F) of this section, is depreciated over the recovery period of the qualified property 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 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 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 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. 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 the applicable percentage for the taxable year in which the underlying property was placed in service by the taxpayer. For purposes of this paragraph (g)(2)(ii), the additional first year depreciation deduction applies to the decrease in basis only if the underlying property is qualified 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 before the decrease in basis, or if the taxpayer claimed more than the additional first year depreciation deduction allowable for the qualified 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 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, the amount of the decrease in basis of the qualified 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 (g)(2)(ii), and the remaining decrease in basis of—

(A) Qualified property, except for computer software described in paragraph (b)(2)(i)(B) of this section, a qualified film or television production described in paragraph (b)(2)(i)(E) of this section, or a qualified live theatrical production described in paragraph (b)(2)(i)(F) of this section, reduces the amount otherwise allowable as a depreciation deduction over the recovery period of the qualified property 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 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 (g)(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 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 (g)(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) *Definitions.* 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 for purposes of this paragraph (g)(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 (g)(2) is illustrated by the following examples:

(A) *Example 1.* (1) On May 15, 2023, YY 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, YY agrees to pay the seller 25 percent of the gross profits from the operation of the property in 2023. On May 15, 2024, YY paid to the seller an additional \$10,000. YY depreciates the 5-year property placed in service in 2023 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.

(2) For 2023, YY is allowed an 80-percent additional first year depreciation deduction of \$160,000 (the unadjusted depreciable basis of \$200,000 multiplied by 0.80). In addition, YY's depreciation deduction for 2023 for the remaining adjusted depreciable basis of \$40,000 (the unadjusted depreciable basis of \$200,000 reduced by the additional first year depreciation deduction of \$160,000) is \$8,000 (the remaining adjusted depreciable basis of \$40,000 multiplied by the annual depreciation rate of 0.20 for recovery year 1).

(3) For 2024, YY's depreciation deduction for the remaining adjusted depreciable basis of \$40,000 is \$12,800 (the remaining adjusted depreciable basis of \$40,000 multiplied by the annual depreciation rate of 0.32 for recovery year 2). In addition, pursuant to paragraph (g)(2)(i) of this section, YY is allowed an additional first year depreciation deduction for 2024 for the \$10,000 increase in basis of the qualified property. Consequently, YY is allowed an additional first year depreciation deduction of \$8,000 (the increase in basis of \$10,000 multiplied by 0.80, the applicable percentage for 2023). Also, YY is allowed a depreciation deduction for 2024 attributable to the remaining increase in basis of \$2,000 (the increase in basis of \$10,000 reduced by the additional first year depreciation deduction of \$8,000). The depreciation deduction allowable for 2024 attributable to the remaining increase in basis of \$2,000 is \$889 (the remaining increase in basis of \$2,000 multiplied by 0.4444, which is equal to 1/remaining recovery period of 4.5 years at January 1, 2024, multiplied by 2). Accordingly, for 2024, YY's total depreciation deduction allowable for the qualified property is \$21,689 (\$12,800 plus \$8,000 plus \$889).

(B) *Example 2.* (1) On May 15, 2023, ZZ, 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, ZZ borrowed \$250,000 from Bank1. On May 15, 2024, Bank1 forgives \$50,000 of the indebtedness. ZZ 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. ZZ depreciates the 5-year property placed in service in 2023 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.

(2) For 2023, ZZ is allowed an 80-percent additional first year depreciation deduction of \$320,000 (the unadjusted depreciable basis of \$400,000 multiplied by 0.80). In addition, ZZ's depreciation deduction allowable for 2023 for the remaining adjusted depreciable basis of \$80,000 (the unadjusted depreciable basis of \$400,000 reduced by the additional first year depreciation deduction of \$320,000) is \$16,000 (the remaining adjusted depreciable basis of \$80,000 multiplied by the annual depreciation rate of 0.20 for recovery year 1).

(3) For 2024, ZZ's deduction for the remaining adjusted depreciable basis of \$80,000 is \$25,600 (the remaining adjusted depreciable basis of \$80,000 multiplied by the annual depreciation rate 0.32 for recovery year 2). Although Bank1 forgave the indebtedness in 2024, the basis of the property is reduced on January 1, 2025, 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.

(4) For 2025, ZZ's deduction for the remaining adjusted depreciable basis of \$80,000 is \$15,360 (the remaining adjusted depreciable basis of \$80,000 multiplied by the annual depreciation rate 0.192 for recovery year 3). However, pursuant to paragraph (g)(2)(ii) of this section, ZZ must reduce the amount otherwise allowable as a depreciation deduction for 2025 by the excess depreciation previously claimed for the \$50,000 decrease in basis of the qualified property. Consequently, ZZ must reduce the amount of depreciation otherwise allowable for 2025 by the excess additional first year depreciation of \$40,000 (the decrease in basis of \$50,000 multiplied by 0.80, the applicable percentage for 2023). Also, ZZ must reduce the amount of depreciation otherwise allowable for 2025 by the excess depreciation attributable to the remaining decrease in basis of \$10,000 (the decrease in basis of \$50,000 reduced by the excess additional first year depreciation of \$40,000). The reduction in the amount of depreciation otherwise allowable for 2025 for the remaining decrease in basis of \$10,000 is \$5,714 (the remaining decrease in basis of \$10,000 multiplied by 0.5714, which is equal to (1/remaining recovery period of 3.5 years at January 1, 2025, multiplied by 2)). Accordingly, assuming the qualified property is the only depreciable property owned by ZZ, for 2025, ZZ has a negative depreciation deduction for the qualified property of \$30,354 (\$15,360 minus \$40,000 minus \$5,714).

(3) *Sections 1245 and 1250 depreciation recapture.* For purposes of section 1245 and §§1.1245-1 through -6, the additional first year depreciation deduction is an amount allowed or allowable for depreciation. Further, for purposes of section 1250(b) and §1.1250-2, 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 even if the taxpayer makes the election to amortize the certified pollution control facility under section 169 and §§1.169-1 through -4 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 (g)(5) apply to replacement MACRS property or replacement computer software that is qualified property at the time of replacement provided the time of replacement is after September 27, 2017, and before January 1, 2027; or, in the case of replacement MACRS property or replacement computer software that is qualified property described in section 168(k)

(2)(B) or (C), the time of replacement is after September 27, 2017, and before January 1, 2028.

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

(A) *Replacement MACRS property* has the same meaning as that term is defined in §1.168(i)-6(b)(1).

(B) *Relinquished MACRS property* has the same meaning as that term is defined in §1.168(i)-6(b)(2).

(C) *Replacement 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 for other computer software in a like-kind exchange or in an involuntary conversion.

(D) *Relinquished computer software* is computer software that is transferred by the taxpayer in a like-kind exchange or in an involuntary conversion.

(E) *Time of disposition* has the same meaning as that term is defined in §1.168(i)-6(b)(3) for relinquished MACRS property. For relinquished computer software, *time of disposition* is when the disposition of the relinquished computer software takes place under the convention determined under §1.167(a)-14(b).

(F) Except as provided in paragraph (g)(5)(iv) of this section, the *time of replacement* has the same meaning as that term is defined in §1.168(i)-6(b)(4) for replacement MACRS property. For replacement computer software, the *time of replacement* is, except as provided in paragraph (g)(5)(iv) of this section, the later of—

(1) When the replacement computer software is placed in service under the convention determined under §1.167(a)-14(b); or

(2) The time of disposition of the relinquished property.

(G) *Exchanged basis* has the same meaning as that term is defined in §1.168(i)-6(b)(7) for MACRS property, as defined in §1.168(b)-1(a)(2). For computer software, the *exchanged basis* is determined after the amortization deductions for the year of disposition are determined under §1.167(a)-14(b) and is the lesser of—

(1) The basis in the replacement computer software, as determined under sec-

tion 1031(d) and §1.1031(d)-1, 1.1031(d)-2, 1.1031(j)-1, or 1.1031(k)-1; or section 1033(b) and §1.1033(b)-1; or

(2) The adjusted depreciable basis of the relinquished computer software.

(H) *Excess basis* has the same meaning as that term is defined in §1.168(i)-6(b)(8) for replacement MACRS property. For replacement computer software, the *excess basis* is any excess of the basis in the replacement computer software, as determined under section 1031(d) and §1.1031(d)-1, 1.1031(d)-2, 1.1031(j)-1, or 1.1031(k)-1; or section 1033(b) and §1.1033(b)-1, over the exchanged basis as determined under paragraph (g)(5)(ii)(G) of this section.

(I) *Remaining exchanged basis* is the exchanged basis as determined under paragraph (g)(5)(ii)(G) of this section reduced by—

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

(2) Any adjustments to basis provided by other provisions of the Code and the regulations under the Code (including section 1016(a)(2) and (3)) for periods prior to the disposition of the relinquished property.

(J) *Remaining excess basis* is the excess basis as determined under paragraph (g)(5)(ii)(H) of this section reduced by—

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

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

(3) Any adjustments to basis provided by other provisions of the Code and the regulations under the Code.

(K) *Year of disposition* has the same meaning as that term is defined in §1.168(i)-6(b)(5).

(L) *Year of replacement* has the same meaning as that term is defined in §1.168(i)-6(b)(6).

(M) *Like-kind exchange* has the same meaning as that term is defined in §1.168(i)-6(b)(11).

(N) *Involuntary conversion* has the same meaning as that term is defined in §1.168(i)-6(b)(12).

(iii) *Computation—(A) In general.* If the replacement MACRS property or the replacement computer software, as applicable, meets the original use requirement in paragraph (b)(3)(ii) of this section and all other requirements of section 168(k) and this section, the remaining exchanged basis for the year of replacement and the remaining excess basis, if any, for the year of replacement for the replacement MACRS property or the replacement computer software, as applicable, are eligible for the additional first year depreciation deduction under this section. If the replacement MACRS property or the replacement computer software, as applicable, meets the used property acquisition requirements in paragraph (b)(3)(iii) of this section and all other requirements of section 168(k) and this section, only the remaining excess basis for the year of replacement for the replacement MACRS property or the replacement computer software, as applicable, is eligible for the additional first year depreciation deduction under this section. See paragraph (b)(3)(iii)(A)(3) of this section. The additional first year depreciation deduction applies to the remaining exchanged basis and any remaining excess basis, as applicable, of the replacement MACRS property or the replacement computer software, as applicable, if the time of replacement is after September 27, 2017, and before January 1, 2027; or, in the case of replacement MACRS property or replacement computer software, as applicable, described in section 168(k)(2)(B) or (C), the time of replacement is after September 27, 2017, and before January 1, 2028. The additional first year depreciation deduction is computed separately for the remaining exchanged basis and any remaining excess basis, as applicable.

(B) *Year of disposition and year of replacement.* The additional first year depreciation deduction is allowable for the replacement MACRS property or replacement computer software in the year of replacement. However, the additional first year depreciation deduction is not allowable for the relinquished MACRS property or the relinquished computer software, as applicable, if the relinquished MACRS

property or the relinquished computer software, as applicable, is placed in service and disposed of in a like-kind exchange or in an involuntary conversion in the same taxable year.

(C) *Property described in section 168(k)(2)(B).* For purposes of paragraph (g)(5)(iii)(A) of this section, the total of the remaining exchanged basis and the remaining excess basis, if any, of the replacement MACRS property that is qualified property described in section 168(k)(2)(B) and meets the original use requirement in paragraph (b)(3)(ii) of this section is limited to the total of the property's remaining exchanged basis and remaining excess basis, if any, attributable to the property's manufacture, construction, or production after September 27, 2017, and before January 1, 2027. For purposes of paragraph (g)(5)(iii)(A) of this section, the remaining excess basis, if any, of the replacement MACRS property that is qualified property described in section 168(k)(2)(B) and meets the used property acquisition requirements in paragraph (b)(3)(iii) of this section is limited to the property's remaining excess basis, if any, attributable to the property's manufacture, construction, or production after September 27, 2017, and before January 1, 2027.

(D) *Effect of §1.168(i)-6(i)(1) election.* If a taxpayer properly makes the election under §1.168(i)-6(i)(1) not to apply §1.168(i)-6 for any MACRS property, as defined in §1.168(b)-1(a)(2), involved in a like-kind exchange or involuntary conversion, then:

(1) If the replacement MACRS property meets the original use requirement in paragraph (b)(3)(ii) of this section and all other requirements of section 168(k) and this section, the total of 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), if any, in the replacement MACRS property is eligible for the additional first year depreciation deduction under this section; or

(2) If the replacement MACRS property meets the used property acquisition requirements in paragraph (b)(3)(iii) of this section and all other requirements of section 168(k) and this section, only the excess basis, as defined in §1.168(i)-6(b)(8), if any, in the replacement MACRS prop-

erty is eligible for the additional first year depreciation deduction under this section.

(E) *Alternative minimum tax.* The additional first year depreciation deduction is allowed for alternative minimum tax purposes for the year of replacement of replacement MACRS property or replacement computer software, as applicable, that is qualified property. If the replacement MACRS property or the replacement computer software, as applicable, meets the original use requirement in paragraph (b)(3)(ii) of this section and all other requirements of section 168(k) and this section, the additional first year depreciation deduction for alternative minimum tax purposes is based on the remaining exchanged basis and the remaining excess basis, if any, of the replacement MACRS property or the replacement computer software, as applicable, for alternative minimum tax purposes. If the replacement MACRS property or the replacement computer software, as applicable, meets the used property acquisition requirements in paragraph (b)(3)(iii) of this section and all other requirements of section 168(k) and this section, the additional first year depreciation deduction for alternative minimum tax purposes is based on the remaining excess basis, if any, of the replacement MACRS property or the replacement computer software, as applicable, for alternative minimum tax purposes.

(iv) *Replacement MACRS property or replacement computer software that is acquired and placed in service before disposition of relinquished MACRS property or relinquished computer software.* If, in an involuntary conversion, a taxpayer acquires and places in service the replacement MACRS property or the replacement computer software, as applicable, before the time of disposition of the involuntarily converted MACRS property or the involuntarily converted computer software, as applicable; and the time of disposition of the involuntarily converted MACRS property or the involuntarily converted computer software, as applicable, is after December 31, 2026, or, in the case of property described in service 168(k)(2)(B) or (C), after December 31, 2027, then—

(A) The time of replacement for purposes of this paragraph (g)(5) is when the replacement MACRS property or replace-

ment computer software, as applicable, 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, as applicable, existed before January 1, 2027, or, in the case of property described in section 168(k)(2)(B) or (C), existed before January 1, 2028; and

(B) The taxpayer depreciates the replacement MACRS property or replacement computer software, as applicable, in accordance with paragraph (e) 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 replacement MACRS property and begins to depreciate the depreciable exchanged basis, as defined in §1.168(i)-6(b)(9), of the replacement 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 replacement MACRS property continues to be depreciated by the taxpayer in accordance with the first sentence of this paragraph (g)(5)(iv)(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 replacement MACRS property over the additional first year depreciation deduction that would have been allowable to the taxpayer on the remaining exchanged basis of the replacement MACRS property at the time of replacement, as defined in paragraph (g)(5)(iv)(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 replacement MACRS property from the date the replacement MACRS property was placed in service by the taxpayer, taking into account the applicable convention, to the time of disposition of the involuntarily converted MACRS property. Similar rules apply to replacement computer software.

(v) *Examples.* The application of this paragraph (g)(5) is illustrated by the following examples:

(A) *Example 1.* (1) In April 2016, CSK, 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)(2), as in effect on the day before amendment by the Act, and is 5-year property under section 168(e). CSK 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. CSK elected to use the optional depreciation tables to compute the depreciation allowance for Canopy V1. In November 2017, Canopy V1 was destroyed in a fire and was no longer usable in CSK's business. In December 2017, in an involuntary conversion, CSK acquired and placed in service Canopy W1 with all of the \$160,000 of insurance proceeds CSK received due to the loss of Canopy V1. Canopy W1 is qualified property under section 168(k)(2) and this section, and is 5-year property under section 168(e). Canopy W1 also meets the original use requirement in paragraph (b)(3)(ii) of this section. CSK did not make the election under §1.168(i)-6(i)(1).

(2) For 2016, CSK is allowed a 50-percent additional first year depreciation deduction of \$100,000 for Canopy V1 (the unadjusted depreciable basis of \$200,000 multiplied by 0.50), and a regular MACRS depreciation deduction of \$20,000 for Canopy V1 (the remaining adjusted depreciable basis of \$100,000 multiplied by the annual depreciation rate of 0.20 for recovery year 1).

(3) For 2017, CSK is allowed a regular MACRS depreciation deduction of \$16,000 for Canopy V1 (the remaining adjusted depreciable basis of \$100,000 multiplied by the annual depreciation rate of 0.32 for recovery year $2 \times \frac{1}{2}$ year).

(4) Pursuant to paragraph (g)(5)(iii)(A) of this section, the additional first year depreciation deduction allowable for Canopy W1 for 2017 equals \$64,000 (100 percent of Canopy W1's remaining exchanged basis at the time of replacement of \$64,000 (Canopy V1's remaining adjusted depreciable basis of \$100,000 minus 2016 regular MACRS depreciation deduction of \$20,000 minus 2017 regular MACRS depreciation deduction of \$16,000)).

(B) *Example 2.* (1) The facts are the same as in Example 1 of paragraph (g)(5)(v)(A)(1) of this section, except CSK elected not to deduct the additional first year depreciation for 5-year property placed in service in 2016. CSK deducted the additional first year depreciation for 5-year property placed in service in 2017.

(2) For 2016, CSK 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 0.20 for recovery year 1).

(3) For 2017, CSK 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 0.32 for recovery year $2 \times \frac{1}{2}$ year).

(4) Pursuant to paragraph (g)(5)(iii)(A) of this section, the additional first year depreciation deduction allowable for Canopy W1 for 2017 equals

\$128,000 (100 percent of Canopy W1's remaining exchanged basis at the time of replacement of \$128,000 (Canopy V1's unadjusted depreciable basis of \$200,000 minus 2016 regular MACRS depreciation deduction of \$40,000 minus 2017 regular MACRS depreciation deduction of \$32,000)).

(C) *Example 3.* The facts are the same as in *Example 1* of paragraph (g)(5)(v)(A)(1) of this section, except Canopy W1 meets the used property acquisition requirements in paragraph (b)(3)(iii) of this section. Because the remaining excess basis of Canopy W1 is zero, CSK is not allowed any additional first year depreciation for Canopy W1 pursuant to paragraph (g)(5)(iii)(A) of this section.

(D) *Example 4.* (1) In December 2016, AB, a calendar-year corporation, acquired for \$10,000 and placed in service Computer X2. Computer X2 is qualified property under section 168(k)(2), as in effect on the day before amendment by the Act, and is 5-year property under section 168(e). AB 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. AB elected to use the optional depreciation tables to compute the depreciation allowance for Computer X2. In November 2017, AB acquired Computer Y2 by exchanging Computer X2 and \$1,000 cash in a like-kind exchange. Computer Y2 is qualified property under section 168(k)(2) and this section, and is 5-year property under section 168(e). Computer Y2 also meets the original use requirement in paragraph (b)(3)(ii) of this section. AB did not make the election under §1.168(i)-6(i)(1).

(2) For 2016, AB is allowed a 50-percent additional first year depreciation deduction of \$5,000 for Computer X2 (unadjusted basis of \$10,000 multiplied by 0.50), and a regular MACRS depreciation deduction of \$1,000 for Computer X2 (the remaining adjusted depreciable basis of \$5,000 multiplied by the annual depreciation rate of 0.20 for recovery year 1).

(3) For 2017, AB is allowed a regular MACRS depreciation deduction of \$800 for Computer X2 (the remaining adjusted depreciable basis of \$5,000 multiplied by the annual depreciation rate of 0.32 for recovery year $2 \times \frac{1}{2}$ year).

(4) Pursuant to paragraph (g)(5)(iii)(A) of this section, the 100-percent additional first year depreciation deduction for Computer Y2 for 2017 is allowable for the remaining exchanged basis at the time of replacement of \$3,200 (Computer X2's unadjusted depreciable basis of \$10,000 minus additional first year depreciation deduction allowable of \$5,000 minus the 2016 regular MACRS depreciation deduction of \$1,000 minus the 2017 regular MACRS depreciation deduction of \$800) and for the remaining excess basis at the time of replacement of \$1,000 (cash paid for Computer Y2). Thus, the 100-percent additional first year depreciation deduction allowable for Computer Y2 totals \$4,200 for 2017.

(E) *Example 5.* (1) In July 2017, BC, a calendar-year corporation, acquired for \$20,000 and placed in service Equipment X3. Equipment X3 is qualified property under section 168(k)(2), as in effect on the day before amendment by the Act, and is 5-year property under section 168(e). BC 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. BC elected to use the optional depreciation tables to compute the depreciation allowance for Equipment X3. In December 2017, BC acquired Equipment Y3 by exchanging Equipment X3 and \$5,000 cash in a like-kind exchange. Equipment Y3 is qualified property under section 168(k)(2) and this section, and is 5-year property under section 168(e). Equipment Y3 also meets the used property acquisition requirements in paragraph (b)(3)(iii) of this section. BC did not make the election under §1.168(i)-6(i)(1).

(2) Pursuant to §1.168(k)-1(f)(5)(iii)(B), no additional first year depreciation deduction is allowable for Equipment X3 and, pursuant to §1.168(d)-1(b)(3)(ii), no regular depreciation deduction is allowable for Equipment X3, for 2017.

(3) Pursuant to paragraph (g)(5)(iii)(A) of this section, no additional first year depreciation deduction is allowable for Equipment Y3's remaining exchanged basis at the time of replacement of \$20,000 (Equipment X3's unadjusted depreciable basis of \$20,000). However, pursuant to paragraph (g)(5)(iii)(A) of this section, the 100-percent additional first year depreciation deduction is allowable for Equipment Y3's remaining excess basis at the time of replacement of \$5,000 (cash paid for Equipment Y3). Thus, the 100-percent additional first year depreciation deduction allowable for Equipment Y3 is \$5,000 for 2017.

(F) *Example 6.* (1) The facts are the same as in *Example 5* of paragraph (g)(5)(v)(E)(1) of this section, except BC properly makes the election under §1.168(i)-6(i)(1) not to apply §1.168(i)-6 to Equipment X3 and Equipment Y3.

(2) Pursuant to §1.168(k)-1(f)(5)(iii)(B), no additional first year depreciation deduction is allowable for Equipment X3 and, pursuant to §1.168(d)-1(b)(3)(ii), no regular depreciation deduction is allowable for Equipment X3, for 2017.

(3) Pursuant to §1.168(i)-6(i)(1), BC is treated as placing Equipment Y3 in service in December 2017 with a basis of \$25,000 (the total of the exchanged basis of \$20,000 and the excess basis of \$5,000). However, pursuant to paragraph (g)(5)(iii)(D)(2) of this section, the 100-percent additional first year depreciation deduction is allowable only for Equipment Y3's excess basis at the time of replacement of \$5,000 (cash paid for Equipment Y3). Thus, the 100-percent additional first year depreciation deduction allowable for Equipment Y3 is \$5,000 for 2017.

(6) *Change in use—(i) Change in use of MACRS property.* The determination of whether the use of MACRS property, as defined in §1.168(b)-1(a)(2), changes is made in accordance with section 168(i)(5) and §1.168(i)-4.

(ii) *Conversion to personal use.* If qualified 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. See §1.168(i)-4(b)(1) for determining the depreciable basis of the property at the time of conversion 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 27, 2017, and converted by the taxpayer from personal use to business or income-producing use by January 1, 2027. 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. See §1.168(i)-4(b)(1) for determining the depreciable basis of the property at the time of conversion 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 changes in the hands of the same taxpayer subsequent to the taxable year the qualified property is placed in service and, as a result of the change in use, the property is no longer qualified property, the additional first year depreciation deduction allowable for the qualified property is not redetermined.

(B) If depreciable property is not qualified 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 in the taxable year of the change in use.

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

(A) *Example 1.* (1) On January 1, 2019, *FFF*, a calendar year corporation, purchased and placed in service several new computers at a total cost of \$100,000. *FFF* used these computers within the United States for 3 months in 2019 and then moved and used the computers outside the United States for the remainder of 2019. On January 1, 2020, *FFF* permanently returns the computers to the United States for use in its business.

(2) For 2019, the computers are considered as used predominantly outside the United States in 2019 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)(B) of this section, the computers are not qualified property in 2019, the placed-in-service year. Thus, pursuant to paragraph (g)(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 2020.

(B) *Example 2.* (1) On February 8, 2023, *GGG*, 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). *GGG* depreciates its 5-year property placed in service in 2023 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, 2024, due to changes in *GGG*'s business circumstances, *GGG* permanently moves the equipment to its plant in Mexico.

(2) For 2023, *GGG* is allowed an 80-percent additional first year depreciation deduction of \$800,000 (the adjusted depreciable basis of \$1,000,000 multiplied by 0.80). In addition, *GGG*'s depreciation deduction allowable in 2023 for the remaining adjusted depreciable basis of \$200,000 (the unadjusted depreciable basis of \$1,000,000 reduced by the additional first year depreciation deduction of \$800,000) is \$40,000 (the remaining adjusted depreciable basis of \$200,000 multiplied by the annual depreciation rate of 0.20 for recovery year 1).

(3) For 2024, 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 \$160,000 for the equipment is required to be depreciated under the alternative depreciation system of section 168(g) beginning in 2024. However, the additional first year

depreciation deduction of \$800,000 allowed for the equipment in 2023 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 \$8,000 for qualified property acquired and placed in service by a taxpayer after September 27, 2017.

(9) *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, 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 (f)(1)(i) 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 §1.168(b)-1(a)(3) 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 (e)(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 (g)(9)(i)(B), the remaining rehabilitated basis is equal to the unadjusted depreciable basis, as defined in §1.168(b)-1(a)(3) but before the reduction in basis for the amount of the rehabilitation credit, of the qualified rehabilitation expenditures that are qualified property reduced by the

additional first year depreciation allowed or allowable, whichever is greater.

(ii) *Example.* The application of this paragraph (g)(9) is illustrated by the following example:

(A) Between February 8, 2023, and June 4, 2023, *JM*, 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 qualified property and qualify for the 20-percent rehabilitation credit under section 47(a)(1). *JM*'s basis in the qualified rehabilitated building is zero before incurring the qualified rehabilitation expenditures and *JM* placed the qualified rehabilitated building in service in July 2023. *JM* depreciates its nonresidential real property placed in service in 2023 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. *JM* elected to use the optional depreciation tables to compute the depreciation allowance for its depreciable property placed in service in 2023. Further, for 2023, *JM* did not make any election under paragraph (f) of this section.

(B) Because *JM* did not make any election under paragraph (f) of this section, *JM* is allowed an 80-percent additional first year depreciation deduction of \$160,000 for the qualified rehabilitation expenditures for 2023 (the unadjusted depreciable basis of \$200,000 (before reduction in basis for the rehabilitation credit) multiplied by 0.80). *JM* also is allowed to claim a rehabilitation credit of \$8,000 for the remaining rehabilitated basis of \$40,000 (the unadjusted depreciable basis (before reduction in basis for the rehabilitation credit) of \$200,000 less the additional first year depreciation deduction of \$160,000, multiplied by 0.20 to calculate the rehabilitation credit). For 2023, the ratable share of the rehabilitation credit of \$8,000 is \$1,600. Further, *JM*'s depreciation deduction for 2023 for the remaining adjusted depreciable basis of \$32,000 (the unadjusted depreciable basis (before reduction in basis for the rehabilitation credit) of \$200,000 less the additional first year depreciation deduction of \$160,000 less the rehabilitation credit of \$8,000) is \$376.64 (the remaining adjusted depreciable basis of \$32,000 multiplied by the depreciation rate of 0.01177 for recovery year 1, placed in service in month 7).

(10) *Coordination with section 514(a)*

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

(11) [Reserved]

(h) *Applicability dates—(1) In general.* Except as provided in paragraphs (h) (2) and (3) of this section, the rules of this section apply to—

(i) Qualified property under section 168(k)(2) that is placed in service by the taxpayer during or after the taxpayer's taxable year that includes September 24, 2019; and

(ii) A specified plant for which the taxpayer properly made an election to apply section 168(k)(5) and that is planted, or grafted to a plant that was previously planted, by the taxpayer during or after the taxpayer's taxable year that includes September 24, 2019.

(2) *Early application of this section.* A taxpayer may choose to apply this section, in its entirety, to—

(i) Qualified property under section 168(k)(2) acquired and placed in service after September 27, 2017, by the taxpayer during the taxpayer's taxable year ending on or after September 28, 2017; and

(ii) A specified plant for which the taxpayer properly made an election to apply section 168(k)(5) and that is planted, or grafted to a plant that was previously planted, after September 27, 2017, by the taxpayer during the taxpayer's taxable year ending on or after September 28, 2017.

(3) *Early application of regulation project REG-104397-18.* A taxpayer may rely on the provisions of this section in regulation project REG-104397-18 (2018-41 I.R.B. 558) (see §601.601(d)(2)(ii)(b) of this chapter) for—

(i) Qualified property under section 168(k)(2) acquired and placed in service after September 27, 2017, by the taxpayer during the taxpayer's taxable year ending on or after September 28, 2017, and ending before the taxpayer's taxable year that includes September 24, 2019; and

(ii) A specified plant for which the taxpayer properly made an election to apply section 168(k)(5) and that is planted, or grafted to a plant that was previously planted, after September 27, 2017, by the taxpayer during the taxpayer's taxable year ending on or after September 28, 2017, and ending before the taxpayer's taxable year that includes September 24, 2019.

Par. 10. Section 1.169-3 is amended by adding a sentence at the end of paragraph (a) and adding three sentences at the end of paragraph (g) to read as follows:

§1.169-3 Amortizable basis.

(a) * * * Further, before computing the amortization deduction allowable under section 169, the adjusted basis for purposes of determining gain for a facility that is acquired and placed in service after September 27, 2017, and that is qualified

property under section 168(k), as amended by the Tax Cuts and Jobs Act, Public Law 115-97 (131 Stat. 2054 (December 22, 2017)) (the "Act"), or §1.168(k)-2, must be reduced by the amount of the additional first year depreciation deduction allowed or allowable, whichever is greater, under section 168(k), as amended by the Act.

* * * * *

(g) * * * The last sentence of paragraph (a) of this section applies to a certified pollution control facility that is qualified property under section 168(k)(2) and placed in service by a taxpayer during or after the taxpayer's taxable year that includes September 24, 2019. However, a taxpayer may choose to apply the last sentence of paragraph (a) of this section to a certified pollution control facility that is qualified property under section 168(k)(2) and acquired and placed in service after September 27, 2017, by the taxpayer during taxable years ending on or after September 28, 2017. A taxpayer may rely on the last sentence in paragraph (a) of this section in regulation project REG-104397-18 (2018-41 IRB 558) (see §601.601(d)(2)(ii)(b) of this chapter) for a certified pollution control facility that is qualified property under section 168(k)(2) and acquired and placed in service after September 27, 2017, by the taxpayer during taxable years ending on or after September 28, 2017, and ending before the taxpayer's taxable year that includes September 24, 2019.

Par. 11. Section 1.179-4 is amended by revising paragraph (c)(2) to read as follows:

§1.179-4 Definitions.

* * * * *

(c) * * *

(2) Property deemed to have been acquired by a new target corporation as a result of a section 338 election (relating to certain stock purchases treated as asset acquisitions) or a section 336(e) election (relating to certain stock dispositions treated as asset transfers) made for a disposition described in §1.336-2(b)(1) will be considered acquired by purchase.

* * * * *

Par. 12. Section 1.179-6 is amended by revising the first sentence in paragraph (a) and adding paragraph (e) to read as follows:

§1.179-6 Effective/applicability dates.

(a) * * * Except as provided in paragraphs (b), (c), (d), and (e) of this section, the provisions of §§1.179-1 through 1.179-5 apply for property placed in service by the taxpayer in taxable years ending after January 25, 1993. * * *

* * * * *

(e) *Application of §1.179-4(c)(2)-(1) In general.* Except as provided in paragraphs (e)(2) and (3) of this section, the provisions of §1.179-4(c)(2) relating to section 336(e) are applicable on or after September 24, 2019.

(2) *Early application of §1.179-4(c)(2).* A taxpayer may choose to apply the provisions of §1.179-4(c)(2) relating to section 336(e) for the taxpayer's taxable years ending on or after September 28, 2017.

(3) *Early application of regulation project REG-104397-18.* A taxpayer may rely on the provisions of §1.179-4(c)(2) relating to section 336(e) in regulation project REG-104397-18 (2018-41 I.R.B. 558) (see §601.601(d)(2)(ii)(b) of this chapter) for the taxpayer's taxable years ending on or after September 28, 2017, and ending before September 24, 2019.

Par. 13. Section 1.312-15 is amended by adding a sentence at the end of paragraph (a)(1) and adding paragraph (e) to read as follows:

§1.312-15 Effect of depreciation on earnings and profits.

(a) * * *

(1) * * * Further, see §1.168(k)-2(g)(7) with respect to the treatment of the additional first year depreciation deduction allowable under section 168(k), as amended by the Tax Cuts and Jobs Act, Public Law 115-97 (131 Stat. 2054 (December 22, 2017)), for purposes of computing the earnings and profits of a corporation.

* * * * *

(e) *Applicability date of qualified property.* The last sentence of paragraph (a)(1) of this section applies to the taxpayer's taxable years ending on or after September 24, 2019. However, a taxpayer may choose to apply the last sentence in paragraph (a)(1) of this section for the taxpayer's taxable years ending on or after September 28, 2017. A taxpayer may rely on the last sentence in paragraph (a)(1) of this section in regulation project REG-104397-18 (2018-41 I.R.B. 558) (see §601.601(d)(2)(ii)(b) of this chapter)

for the taxpayer's taxable years ending on or after September 28, 2017, and ending before the taxpayer's taxable year that includes September 24, 2019.

Par. 14. Section 1.704-1 is amended by adding three sentences at the end of paragraph (b)(1)(ii)(a) and adding a sentence at the end of paragraph (b)(2)(iv)(g)(3) to read as follows:

§ 1.704-1 Partner's distributive share.

* * * * *

(b) * * *

(1) * * *

(ii) * * *

(a) * * * The last sentence of paragraph (b)(2)(iv)(g)(3) of this section is applicable for partnership taxable years ending on or after September 24, 2019. However, a partnership may choose to apply the last sentence in paragraph (b)(2)(iv)(g)(3) of this section for the partnership's taxable years ending on or after September 28, 2017. A partnership may rely on the last sentence in paragraph (b)(2)(iv)(g)(3) of this section in regulation project REG-104397-18 (2018-41 I.R.B. 558) (see §601.601(d)(2)(ii)(b) of this chapter) for the partnership's taxable years ending on or after September 28, 2017, and ending before the partnership's taxable year that includes September 24, 2019.

* * * * *

(2) * * *

(iv) * * *

(g) * * *

(3) * * * For purposes of the preceding sentence, additional first year depreciation deduction under section 168(k) is not a reasonable method.

* * * * *

Par. 15. Section 1.704-3 is amended by adding a sentence at the end of paragraph (d)(2), revising the first sentence in paragraph (f), and adding three sentences at the end of paragraph (f) to read as follows:

§ 1.704-3 Contributed property.

* * * * *

(d) * * *

(2) * * * However, the additional first year depreciation deduction under section 168(k) is not a permissible method for purposes of the preceding sentence and, if a partnership has acquired property in a taxable year for which the additional first year depreciation deduction under section 168(k) has been used of the same type as the contributed property, the portion of

the contributed property's book basis that exceeds its adjusted tax basis must be recovered under a reasonable method. See §1.168(k)-2(b)(3)(iv)(B).

* * * * *

(f) * * * With the exception of paragraphs (a)(1), (a)(8)(ii) and (iii), and (a)(10) and (11) of this section, and of the last sentence in paragraph (d)(2) of this section, this section applies to property contributed to a partnership and to restatements pursuant to §1.704-1(b)(2)(iv)(f) on or after December 21, 1993. * * * The last sentence of paragraph (d)(2) of this section applies to property contributed to a partnership on or after September 24, 2019. However, a taxpayer may choose to apply the last sentence in paragraph (d)(2) of this section for property contributed to a partnership on or after September 28, 2017. A taxpayer may rely on the last sentence in paragraph (d)(2) of this section in regulation project REG-104397-18 (2018-41 I.R.B. 558) (see §601.601(d)(2)(ii)(b) of this chapter) for property contributed to a partnership on or after September 28, 2017, and ending before September 24, 2019.

* * * * *

Par. 16. Section 1.743-1 is amended by adding three sentences to the end of paragraph (j)(4)(i)(B)(1), adding one new sentence at the end of paragraph (j)(4)(i)(B)(2), and adding three sentences at the end of paragraph (l) to read as follows:

§ 1.743-1 Optional adjustment to basis of partnership property.

* * * * *

(j) * * *

(4) * * *

(i) * * *

(B) * * *

(l) * * * The partnership is allowed to deduct the additional first year depreciation under section 168(k) and §1.168(k)-2 for an increase in the basis of qualified property, as defined in section 168(k) and §1.168(k)-2, under section 743(b) in a class of property, as defined in §1.168(k)-2(f)(1)(ii)(A) through (F), even if the partnership made the election under section 168(k)(7) and §1.168(k)-2(f)(1) not to deduct the additional first year depreciation for all other qualified property of the partnership in the same class of property, as defined in §1.168(k)-2(f)(1)(ii)(A) through (F), and placed in service in the

same taxable year, provided the section 743(b) basis adjustment meets all requirements of section 168(k) and §1.168(k)-2. Further, the partnership may make an election under section 168(k)(7) and §1.168(k)-2(f)(1) not to deduct the additional first year depreciation for an increase in the basis of qualified property, as defined in section 168(k) and §1.168(k)-2, under section 743(b) in a class of property, as defined in §1.168(k)-2(f)(1)(ii)(A) through (F), and placed in service in the same taxable year, even if the partnership does not make that election for all other qualified property of the partnership in the same class of property, as defined in §1.168(k)-2(f)(1)(ii)(A) through (F), and placed in service in the same taxable year. In this case, the section 743(b) basis adjustment must be recovered under a reasonable method.

(2) * * * The first sentence of this paragraph (j)(4)(i)(B)(2) does not apply to a partnership that is not a publicly traded partnership within the meaning of section 7704(b) with respect to any basis increase under section 743(b) that is recovered using the additional first year depreciation deduction under section 168(k).

* * * * *

(l) * * * The last three sentences of paragraph (j)(4)(i)(B)(1) of this section, and the last sentence of paragraph (j)(4)(i)(B)(2) of this section, apply to transfers of partnership interests that occur on or after September 24, 2019. However, a partnership may choose to apply the last three sentences in paragraph (j)(4)(i)(B)(1) of this section, and the last sentence of paragraph (j)(4)(i)(B)(2) of this section, for transfers of partnership interests that occur on or after September 28, 2017. A partnership may rely on the last three sentences in paragraph (j)(4)(i)(B)(1) of this section in regulation project REG-104397-18 (2018-41 I.R.B. 558) (see §601.601(d)(2)(ii)(b) of this chapter) for transfers of partnership interests that occur on or after September 28, 2017, and ending before September 24, 2019.

Kirsten Wielobob,
Deputy Commissioner for Services
and Enforcement.

Approved: September 11, 2019.

David J. Kautter
Assistant Secretary of the Treasury
(Tax Policy).

(Filed by the Office of the Federal Register on September 17, 2019, 4:15 p.m., and published in the issue of the Federal Register for September 24, 2019, 84 F.R. 50108)

26 CFR 1.401(k)-1: Certain cash or deferred arrangements

TD 9875

DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Part 1

Hardship Distributions of Elective Contributions, Qualified Matching Contributions, Qualified Nonelective Contributions, and Earnings

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations.

SUMMARY: This document contains final regulations that amend the rules relating to hardship distributions from section 401(k) plans. The final regulations reflect statutory changes affecting section 401(k) plans, including changes made by the Bipartisan Budget Act of 2018. The regulations affect participants in, beneficiaries of, employers maintaining, and administrators of plans that include cash or deferred arrangements or provide for employee or matching contributions.

DATES: *Effective Date:* These regulations are effective September 23, 2019.

Applicability Date: For dates of applicability, see §1.401(k)-1(d)(3)(v).

FOR FURTHER INFORMATION CONTACT: Roger Kuehnle at (202) 317-4148 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Paperwork Reduction Act

The collection of information contained in these final regulations has been reviewed and approved by the Office of Management and Budget in accordance with the Paperwork Reduction Act of 1995 (44 U.S.C. 3507(d)) under control number 1545-1669. The collection of information in these final regulations is in §1.401(k)-1(d)(3)(iii)(B). The collection of information relates to the certification by participants in section 401(k) plans that they have insufficient cash or other liquid assets reasonably available to cover expenses resulting from a hardship and, thus, will need a distribution from the plan to meet the expenses. The collection of information is required to obtain a benefit.

The likely recordkeepers are individuals.

Estimated total annual reporting burden: 101,250 hours.

Estimated average annual burden per respondent: 45 minutes.

Estimated number of respondents: 135,000.

Estimated frequency of responses: On occasion.

An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless it displays a valid control number assigned by the Office of Management and Budget.

Background

Section 401(k)

Section 401(k)(1) of the Internal Revenue Code (Code) provides that a profit-sharing, stock bonus, pre-ERISA money purchase, or rural cooperative plan will not fail to qualify under section 401(a) merely because it includes a cash or deferred arrangement (CODA) that is a qualified CODA. Under section 401(k)(2), a CODA (generally, an arrangement providing for an election by an employee between contributions to a plan or payments directly in cash) is a qualified CODA only if it satisfies certain requirements. Section 401(k)(2)(B) provides that contributions made pursuant to a qualified CODA (referred to as “elective contributions”) may be dis-

tributed only on or after the occurrence of certain events, including death, disability, severance from employment, termination of the plan, attainment of age 59-1/2, hardship, or, in the case of a qualified reservist distribution, the date a reservist is called to active duty. Section 401(k)(2)(C) requires that elective contributions be nonforfeitable at all times.

Section 401(k)(3)(A)(ii) requires that elective contributions satisfy the actual deferral percentage (ADP) test set forth in section 401(k)(3). Sections 401(k)(11), 401(k)(12), and 401(k)(13) each provide an alternative method of meeting the ADP test. Under section 401(k)(3)(D), qualified nonelective contributions (QNECs) and qualified matching contributions (QMAs), as described in sections 401(m)(4)(C) and 401(k)(3)(D)(ii)(I), respectively, are permitted to be taken into account under the ADP test. Among other requirements, QNECs and QMAs must satisfy the distribution limitations of section 401(k)(2)(B) and the nonforfeitality requirements of section 401(k)(2)(C). Similarly, employer contributions that are made pursuant to the safe harbor plan designs of section 401(k)(12) or (13) must meet the distribution limitations of section 401(k)(2)(B).

Section 401(m)(2)(A) requires that matching contributions and employee contributions satisfy the actual contribution percentage (ACP) test set forth in section 401(m)(2). Sections 401(m)(10), 401(m)(11), and 401(m)(12) each provide an alternative method of meeting the ACP test with respect to matching contributions. As with contributions made to section 401(k) plans pursuant to safe harbor plan designs, employer contributions made pursuant to the safe harbor plan designs of section 401(m)(11) or (12) must meet the distribution limitations of section 401(k)(2)(B).

Existing Regulations Under Section 401(k)

The Department of the Treasury (Treasury Department) and the IRS issued comprehensive regulations under sections 401(k) and 401(m) on December 29, 2004 (TD 9169, 69 FR 78143). Since that time, the regulations have been updated to reflect certain subsequent changes to the applicable statute (see TD 9237, 71

FR 6, and TD 9324, 72 FR 21103, providing guidance on designated Roth contributions under section 402A; and TD 9447, 74 FR 8200, providing guidance on section 401(k)(13)). Although the regulations have not been updated to reflect other statutory changes, they have been amended to address certain discrete issues unrelated to statutory changes (see TD 9319, 72 FR 16878, relating to the definition of compensation; TD 9641, 78 FR 68735, relating to mid-year amendments to safe harbor plan designs; and TD 9835, 83 FR 34469, relating to whether QNECs and QMACs must be nonforfeitable when contributed to the plan).

Section 1.401(k)-1(d)(3) provides rules for determining whether a distribution is made on account of an employee's hardship. Under those rules, a distribution is made on account of hardship only if the distribution is made on account of an immediate and heavy financial need and the amount of the distribution is not in excess of the amount necessary to satisfy that need (plus any amounts necessary to pay any taxes or penalties reasonably anticipated to result from the distribution). These determinations must be made on the basis of all the relevant facts and circumstances and in accordance with non-discriminatory and objective standards set forth in the plan.

Section 1.401(k)-1(d)(3)(iv)(B) provides that a distribution is not treated as necessary to satisfy an immediate and heavy financial need of an employee to the extent the need may be relieved from other resources that are reasonably available to the employee (including assets of the employee's spouse and minor children that are reasonably available to the employee). Under §1.401(k)-1(d)(3)(iv)(C), in determining whether the need can be relieved from other resources that are reasonably available to an employee, the employer may rely on the employee's representation (unless the employer has actual knowledge to the contrary) that the need cannot reasonably be relieved from resources specified in §1.401(k)-1(d)(3)(iv)(C).

To simplify administration, the regulations provide certain safe harbors that may be used to determine whether a distribution is made on account of an employee's hardship. Specifically,

§1.401(k)-1(d)(3)(iii)(B) provides a safe harbor under which distributions for six types of expenses are deemed to be made on account of an immediate and heavy financial need. One of the six types is "expenses for the repair of damage to the employee's principal residence that would qualify for the casualty deduction under section 165 (determined without regard to whether the loss exceeds 10% of adjusted gross income)."

In addition, §1.401(k)-1(d)(3)(iv)(E) provides a safe harbor under which a distribution is deemed necessary to satisfy an immediate and heavy financial need. Under that safe harbor, an employee must first obtain all currently available distributions (including distributions of employee stock ownership plan (ESOP) dividends under section 404(k), but not hardship distributions), and nontaxable plan loans from the plan and any other plan maintained by the employer. Under the safe harbor, an employee's ability to make elective contributions and employee contributions to the plan (and any other plan maintained by the employer) must be suspended for at least 6 months after receipt of the hardship distribution. Pursuant to §1.401(k)-3(c)(6)(v)(B), in the case of a safe harbor plan described in section 401(k)(12) or (13), the suspension period may not exceed 6 months.

Under §1.401(k)-1(d)(3)(ii), the maximum amount that may be distributed on account of hardship is the total of the employee's elective contributions that have not previously been distributed (plus earnings, QNECs, and QMACs credited before a specified grandfather date that generally is before 1989). Thus, the maximum amount that may be distributed on account of hardship does not include earnings, QNECs, or QMACs that are not grandfathered.

Section 403(b)

Section 403(b)(7)(A)(ii) provides distribution limitations on amounts contributed to a custodial account that is treated as a section 403(b) annuity contract. Section 403(b)(11) provides that contributions made pursuant to a salary reduction agreement (within the meaning of section 402(g)(3)(C)) (generally referred to in the regulations under section 403(b) as

"section 403(b) elective deferrals") may be distributed only on or after the occurrence of certain events, one of which is the employee's hardship. Section 403(b)(11) also provides that no income attributable to these contributions may be distributed on account of hardship.

Section 1.403(b)-6 provides rules for applying these distribution limitations. Section 1.403(b)-6(b) applies to distributions of amounts that are neither attributable to section 403(b) elective deferrals nor made from custodial accounts, §1.403(b)-6(c) applies to distributions from custodial accounts that are not attributable to section 403(b) elective deferrals, and §1.403(b)-6(d) applies to distributions of amounts attributable to section 403(b) elective deferrals. Section 1.403(b)-6(d)(2) provides that a hardship distribution of section 403(b) elective deferrals is subject to the rules and restrictions set forth in §1.401(k)-1(d)(3) and is limited to the aggregate dollar amount of a participant's section 403(b) elective deferrals, without earnings thereon.

Statutory Changes Relating to Section 401(k)

Section 41113 of the Bipartisan Budget Act of 2018, Pub. L. 115-123 (BBA 2018), directs the Secretary of the Treasury to modify §1.401(k)-1(d)(3)(iv)(E) to (1) delete the 6-month prohibition on contributions following a hardship distribution and (2) make any other modifications necessary to carry out the purposes of section 401(k)(2)(B)(i)(IV). Section 41114 of BBA 2018 modified the hardship distribution rules under section 401(k)(2)(B) by adding section 401(k)(14)(A) to the Code, which states that the maximum amount available for distribution upon hardship includes (1) contributions to a profit-sharing or stock bonus plan to which section 402(e)(3) applies, (2) QNECs, (3) QMACs, and (4) earnings on these contributions. Section 41114 of BBA 2018 also added section 401(k)(14)(B) to the Code, which provides that a distribution is not treated as failing to be made upon the hardship of an employee solely because the employee does not take any available loan under the plan.

Section 11044 of the Tax Cuts and Jobs Act, Pub. L. 115-97 (TCJA), added sec-

tion 165(h)(5) to the Code. Section 165(h)(5) provides that, for taxable years 2018 through 2025, the deduction for a personal casualty loss generally is available only to the extent the loss is attributable to a federally declared disaster (as defined in section 165(i)(5)).

Section 826 of the Pension Protection Act of 2006, Pub. L. 109-280 (PPA '06), directs the Secretary of the Treasury to modify the rules relating to hardship distributions to permit a section 401(k) plan to treat a participant's beneficiary under the plan the same as the participant's spouse or dependent in determining whether the participant has incurred a hardship. Notice 2007-7, 2007-5 I.R.B. 395, provides guidance for applying this provision.

Section 827(a) of PPA '06 added to the Code section 72(t)(2)(G), which exempts certain distributions from the application of the section 72(t) additional income tax on early distributions. These distributions, made during the period that a reservist has been called to active duty, are referred to as "qualified reservist distributions," and could include distributions attributable to elective contributions. Section 827(b)(1) of PPA '06 added section 401(k)(2)(B)(i)(V) to the Code, which permits qualified reservist distributions to be made from a section 401(k) plan.¹

Section 105(b)(1)(A) of the Heroes Earnings Assistance and Relief Tax Act of 2008, Pub. L. 110-245 (HEART Act), added section 414(u)(12) to the Code. Section 414(u)(12)(B)(ii) provides for a 6-month suspension of elective contributions and employee contributions after certain distributions to individuals performing service in the uniformed services.

On November 14, 2018, the Treasury Department and the IRS published proposed regulations (REG-107813-18) under section 401(k) and (m) in the **Federal Register** (83 FR 56763). No public hearing was requested or held. Seven comments on the proposed regulations were received during the comment period. After consideration of the comments, the proposed regulations are adopted as revised by this Treasury decision.

Summary of Comments and Explanation of Provisions

Overview

The final regulations update the section 401(k) and (m) regulations to reflect: (1) the enactment of (a) sections 41113 and 41114 of BBA 2018, (b) sections 826 and 827 of PPA '06, and (c) section 105(b)(1)(A) of the HEART Act; and (2) the application of the hardship distribution rules in light of the modification to the casualty loss deduction rules made by section 11044 of the TCJA. The final regulations are substantially similar to the proposed regulations, and plans that complied with the proposed regulations will satisfy the final regulations.

Deemed Immediate and Heavy Financial Need

The final regulations, like the proposed regulations, modify the safe harbor list of expenses in existing §1.401(k)-1(d)(3)(iii)(B) for which distributions are deemed to be made on account of an immediate and heavy financial need by: (1) adding "primary beneficiary under the plan" as an individual for whom qualifying medical, educational, and funeral expenses may be incurred; (2) modifying the expense listed in existing §1.401(k)-1(d)(3)(iii)(B)(6) (relating to damage to a principal residence that would qualify for a casualty deduction under section 165) to provide that for this purpose the limitations in section 165(h)(5) (added by section 11044 of the TCJA) do not apply; and (3) adding a new type of expense to the list, relating to expenses incurred as a result of certain disasters.

Several commenters observed that this new safe harbor expense, which is described in the preamble to the proposed regulations as similar to relief provided by the IRS after certain major federally declared disasters, is narrower in certain respects than this past IRS relief and asked for confirmation that the narrowing is intentional. Some commenters also raised the concern that the new safe harbor ex-

pense would lead the IRS to discontinue its practice of issuing announcements providing such relief. The effect of the new safe harbor expense differs from the disaster-relief announcements in three main respects.

First, only disaster-related expenses and losses of an employee who lived or worked in the disaster area will qualify for the new safe harbor expense, and not, as under the disaster-relief announcements, expenses and losses of the employee's relatives and dependents. The Treasury Department and IRS have concluded that limiting distributions only to those employees directly affected by a disaster is consistent with the purposes underlying the Code's hardship distribution provisions and better aligns with the relief given to affected individuals under section 7508A for similar disasters.

Second, unlike under the disaster-relief announcements, there is no specific deadline by which a request for a disaster-related hardship distribution must be made and no specific authority to relax certain procedural requirements established by the plan administrator or plan terms (although it is expected that plan administrators will be flexible in interpreting plan terms requiring documentation relating to the hardship when processing hardship distribution requests during the difficult circumstances following a disaster).

Third, unlike under the disaster-relief announcements, there is no extended deadline for plan sponsors to add disaster-related distribution or loan provisions to the plan. In the absence of such an extended deadline, a plan sponsor that does not choose to add disaster-related hardship distribution provisions as part of an amendment reflecting the final regulations but instead chooses to wait until a disaster occurs to add those provisions (or to add a loan provision) would need to adopt a plan amendment by the end of the plan year the amendment is first effective.

Making expenses related to certain disasters a safe harbor expense is intended to eliminate any delay or uncertainty concerning access to plan funds that might otherwise occur following a major disas-

¹ While section 827(b)(2) and (3) of PPA '06 amended section 403(b)(7)(A)(ii) and (b)(11) to permit qualified reservist distributions to be made from a section 403(b) plan, the regulations under section 403(b) have not yet been updated to reflect these statutory amendments.

ter. Accordingly, the Treasury Department and IRS expect that no more disaster-relief announcements will be needed. However, the Treasury Department and IRS are considering separate guidance to address delayed amendment deadlines when the new safe harbor expense or loan provisions are added to a plan at a later date in response to a particular disaster.

Distribution Necessary to Satisfy Financial Need

Pursuant to sections 41113 and 41114 of BBA 2018, the final regulations, like the proposed regulations, modify the rules for determining whether a distribution is necessary to satisfy an immediate and heavy financial need by eliminating (1) any requirement that an employee be prohibited from making elective contributions and employee contributions after receipt of a hardship distribution and (2) any requirement to take plan loans prior to obtaining a hardship distribution. In particular, the final regulations, like the proposed regulations, eliminate the safe harbor in existing §1.401(k)-1(d)(3)(iv)(E), under which a distribution is deemed necessary to satisfy the financial need only if elective contributions and employee contributions are suspended for at least 6 months after a hardship distribution is made and, if available, nontaxable plan loans are taken before the hardship distribution is made.

The proposed regulations eliminate the rules in existing §1.401(k)-1(d)(3)(iv)(B) (under which the determination of whether a distribution is necessary to satisfy a financial need is based on all the relevant facts and circumstances) and provide one general standard for determining whether a distribution is necessary. Under this general standard, a hardship distribution may not exceed the amount of an employee's need (including any amounts necessary to pay any federal, state, or local income taxes or penalties reasonably anticipated to result from the distribution), the employee must have obtained other available, non-hardship distributions under the employer's plans, and the employee must provide a representation that he or she has insufficient cash or other liquid assets available to satisfy the financial need. A hardship distribution may not be made if the plan administrator has actual knowl-

edge that is contrary to the representation. These modifications are adopted in the final regulations with the changes described later in this preamble relating to employee representations and the type of plans subject to the prohibition on suspensions.

Two commenters asked that ESOP dividends under section 404(k) be excepted from the requirement that an employee must first obtain other currently available distributions under the employer's plans. Alternatively, they asked that plans be permitted to disregard that distribution requirement with respect to those dividends if the dividends are less than a specified dollar amount. The comments appear to reflect a misinterpretation of the breadth of the distribution requirement. Under both the existing regulations and the proposed regulations, the distribution requirement applies only to distributions that are "currently available," which significantly limits the ESOP dividends subject to the rule. Specifically, the only ESOP dividends that must be distributed under this rule are those that, at the time of the employee's hardship withdrawal request, both (1) have been paid to the plan and (2) are available for the employee to elect to receive in cash. Thus, for example, if an ESOP requires a participant to make an irrevocable election whether to receive a dividend by a deadline that is in advance of the dividend payment date, then a participant who does not elect to receive the dividend by that deadline and who later requests a hardship distribution has no dividends currently available. Although in some instances these ESOP dividend amounts may be small and, if distributed, would have a minimal impact on alleviating a hardship, the Treasury Department and IRS have concluded that ESOP dividends should not be treated differently than any other nonhardship distributions that are currently available under the plan. Accordingly, no changes were made in response to these comments.

One commenter was concerned that the requirement for an employee to make a representation regarding the unavailability of cash or other liquid assets to satisfy the financial need would be a problem if the employee has those assets but has another immediate need for them. In response to the comment, the final regulations provide that the employee representation only re-

lates to whether the employee has cash or other liquid assets that are "reasonably available" to satisfy the need. Thus, an employee could make a representation that he or she has insufficient cash or other liquid assets reasonably available to satisfy a financial need even if the employee did have cash or other liquid assets on hand, provided those assets were earmarked for payment of an obligation in the near future (for example, rent).

The proposed regulations provide that the employee representation may be made "in writing, by an electronic medium, or in such other form as may be prescribed by the Commissioner." One commenter asked for clarification that a verbal representation via telephone could be used if it is recorded. The final regulations clarify that this method is acceptable, by referencing the definition of "electronic medium" at §1.401(a)-21(e)(3).

Two commenters asked for clarification of the requirement that a plan administrator not have "actual knowledge" that is contrary to an employee's representation or, alternatively, they asked that the requirement be eliminated. The requirement does not impose upon plan administrators an obligation to inquire into the financial condition of employees who seek hardship distributions. Rather, the rule is limited to situations in which the plan administrator already possesses sufficiently accurate information to determine the veracity of an employee representation. The Treasury Department and IRS believe the requirement helps ensure the integrity of the procedures used to determine whether a distribution is necessary to satisfy an employee's financial need. Accordingly, the final regulations retain the actual-knowledge requirement.

The final regulations, like the proposed regulations, provide that a plan generally may provide for additional conditions, such as those described in 26 CFR 1.401(k)-1(d)(3)(iv)(B) and (C) (revised as of April 1, 2019), to demonstrate that a distribution is necessary to satisfy an immediate and heavy financial need of an employee. However, like the proposed regulations, the final regulations do not permit a plan to provide for a suspension of elective contributions or employee contributions as a condition of obtaining a hardship distribution. This is

responsive to Congress' concern in enacting section 41113 of BBA 2018 that a suspension impedes an employee's ability to replace distributed funds. See the Ways and Means Committee description of section 1503 of H.R. 1,² which became section 41113 of BBA 2018.

One commenter asked what conditions, besides those listed in existing §1.401(k)-1(d)(3)(iv)(B) and (C) (other than a suspension of contributions), could be imposed on a hardship distribution, suggesting that completing a plan's application process and providing required documentation should be permissible conditions. The Treasury Department and IRS agree that these two conditions are permissible. The Treasury Department and IRS also note that plan sponsors have available a broad range of conditions that may be imposed on a hardship distribution; for example, a plan could provide for a nondiscriminatory, minimum dollar amount for a hardship distribution.

Another commenter recommended that the prohibition on suspensions of elective contributions and employee contributions in the proposed regulations be eliminated and plan sponsors be given the flexibility to impose a suspension. However, in light of Congress' expressed concern that a suspension impedes an employee's ability to replace distributed funds, the final regulations retain the prohibition on suspensions.

Another commenter requested guidance on which other plans of the employer, besides the plan making the hardship distribution, are subject to the prohibition on suspensions. Although the existing safe harbor in §1.401(k)-1(d)(3)(iv)(E)(2) imposes a mandatory suspension with respect to all qualified and nonqualified plans maintained by the employer, the proposed regulations do not specify the plans to which the prohibition on suspensions applies. The Treasury Department and IRS have concluded that Congress' concerns underlying section 41113 of BBA 2018 have little relevance to unfunded nonqualified plans. Accordingly, the final regulations provide that the prohibition on suspensions applies only to a qualified

plan, a section 403(b) plan, and an eligible deferred compensation plan described in section 457(b) maintained by an eligible employer described in section 457(e)(1)(A). Thus, a plan subject to section 409A may retain its suspension provisions (or, to the extent consistent with section 409A and the regulations thereunder, the plan may be amended to remove them).

Another commenter requested guidance on the continuing applicability of revenue rulings that require a "substantial limitation" on the right of a participant to withdraw matched employee contributions, such as a suspension of contributions. See, for example, Rev. Rul. 74-56, 1974-1 C.B. 90. Under the final regulations, if, on or after January 1, 2020, matched employee contributions are distributed in conjunction with a hardship distribution of elective contributions, a suspension of employee contributions is not permitted.³

Expanded Sources for Hardship Distributions

Pursuant to section 41114 of BBA 2018, the final regulations, like the proposed regulations, modify existing §1.401(k)-1(d)(3) to permit hardship distributions from section 401(k) plans of elective contributions, QNECs, QMACs, and earnings on these amounts, regardless of when contributed or earned.

Several commenters asked how the new distribution rules apply to safe harbor contributions made to a plan described in section 401(k)(12). Because safe harbor contributions made to a plan described in section 401(k)(12) are either QNECs or QMACs, amounts attributable to these contributions may be distributed on account of hardship. As noted in the preamble to the proposed regulations, safe harbor contributions made to a plan described in section 401(k)(13) may also be distributed on account of an employee's hardship (because these contributions are subject to the same distribution limitations applicable to QNECs and QMACs). See §1.401(k)-3(k)(3)(i). However, a plan may limit the type of contributions avail-

able for hardship distributions and may exclude earnings on those contributions from hardship distribution eligibility.

Section 403(b) Plans

Section 1.403(b)-6(d)(2) provides that a hardship distribution of section 403(b) elective deferrals is subject to the rules and restrictions set forth in §1.401(k)-1(d)(3); accordingly, the preamble to the proposed regulations states that the new rules relating to a hardship distribution of elective contributions from a section 401(k) plan generally apply to section 403(b) plans. Two commenters asked whether, in light of historical concerns about employee self-certification in section 403(b) plans, the employee-representation requirement applies to section 403(b) plans. Because this requirement is retained in the final regulations, at §1.401(k)-1(d)(3)(iii)(B), it applies to section 403(b) plans.

The preamble to the proposed regulations addresses other issues related to hardship distributions under section 403(b) plans, and states that because Code section 403(b)(11) was not amended by section 41114 of BBA 2018, income attributable to section 403(b) elective deferrals continues to be ineligible for distribution on account of hardship. As also stated in that preamble, amounts attributable to QNECs and QMACs may be distributed from a section 403(b) plan on account of hardship only to the extent that, under §1.403(b)-6(b) and (c), hardship is a permitted distributable event for amounts that are not attributable to section 403(b) elective deferrals. Thus, QNECs and QMACs in a section 403(b) plan that are not in a custodial account may be distributed on account of hardship, but QNECs and QMACs in a section 403(b) plan that are in a custodial account continue to be ineligible for distribution on account of hardship.

Applicability Dates

The changes to the hardship distribution rules made by BBA 2018 are effective for plan years beginning after December

²H.R. Rep. No. 115-409, at 196 (2017).

³Issues relating to the applicability of prior revenue rulings to distributions of matched employee contributions not made in conjunction with a hardship distribution of elective contributions are beyond the scope of these regulations.

31, 2018. The final regulations provide plan sponsors with a number of applicability-date options. Although presented differently in the proposed regulations, the options available to plan sponsors under the final regulations are the same as those available under the proposed regulations.

In response to a comment on the proposed regulations requesting clarity regarding which rules apply during 2019, the final regulations provide that §1.401(k)-1(d)(3) applies to distributions made on or after January 1, 2020 (rather than, as in the proposed regulations, to distributions made in plan years beginning after December 31, 2018). However, §1.401(k)-1(d)(3) may be applied to distributions made in plan years beginning after December 31, 2018, and the prohibition on suspending an employee's elective contributions and employee contributions as a condition of obtaining a hardship distribution may be applied as of the first day of the first plan year beginning after December 31, 2018, even if the distribution was made in the prior plan year. Thus, for example, a calendar-year plan that provides for hardship distributions under the pre-2019 safe harbor standards may be amended to provide that an employee who receives a hardship distribution in the second half of the 2018 plan year will be prohibited from making contributions only until January 1, 2019 (or may continue to provide that contributions will be suspended for the originally scheduled 6 months).

If the choice is made to apply §1.401(k)-1(d)(3) to distributions made before January 1, 2020, the new rules requiring an employee representation and prohibiting a suspension of contributions may be disregarded with respect to those distributions. To the extent early application of §1.401(k)-1(d)(3) is not chosen, the rules in §1.401(k)-1(d)(3), prior to amendment by this Treasury decision, apply to distributions made before January 1, 2020, taking into account statutory changes effective before 2020 that are not reflected in that regulation.

In addition, the revised list of safe harbor expenses may be applied to distributions made on or after a date that is as early as January 1, 2018. Thus, for example, a plan that made hardship distributions relating to casualty losses deductible under

section 165 without regard to the changes made to section 165 by the TCJA (which, effective in 2018, require that, to be deductible, losses must result from a federally declared disaster) may be amended to apply the revised safe harbor expense relating to casualty losses to distributions made in 2018, so that plan provisions will conform to the plan's operation. Similarly, a plan may be amended to apply the revised safe harbor expense relating to losses (including loss of income) incurred by an employee on account of a disaster that occurred in 2018, provided that the employee's principal residence or principal place of employment at the time of the disaster was located in an area designated by the Federal Emergency Management Agency for individual assistance with respect to the disaster.

Plan Amendments

The Treasury Department and IRS expect that plan sponsors will need to amend their plans' hardship distribution provisions to reflect the final regulations, and any such amendment must be effective for distributions beginning no later than January 1, 2020. The deadline for amending a disqualifying provision is set forth in Rev. Proc. 2016-37, 2016-29 I.R.B. 136. For example, with respect to an individually designed plan that is not a governmental plan, the deadline for amending the plan to reflect a change in qualification requirements is the end of the second calendar year that begins after the issuance of the Required Amendments List (RAL) described in section 9 of Rev. Proc. 2016-37 that includes the change; if the final regulations are included in the 2019 RAL, the deadline will be December 31, 2021.

A plan provision that does not result in the failure of the plan to satisfy the qualification requirements, but is integrally related to a qualification requirement that has been changed in a manner that requires the plan to be amended, may be amended by the same deadline that applies to the required amendment. The Treasury Department and IRS have determined that a plan amendment modifying a plan's hardship distribution provisions that is effective no later than the required amendment, including a plan amendment reflecting one or more of the following, will be treated

as amending a provision that is integrally related to a qualification requirement that has been changed: (1) the change to section 165 (relating to casualty losses); (2) the addition of the new safe harbor expense (relating to expenses incurred as a result of certain federally declared disasters); and (3) the extension of the relief under Announcement 2017-15, 2017-47 I.R.B. 534, to victims of Hurricanes Florence and Michael that was provided in the preamble to the proposed regulations. Thus, in the case of an individually designed plan, the deadline for such an integrally related amendment will be the same as the deadline for the required amendment (described in the preceding paragraph), even if some of the amendment provisions have an earlier effective date.

Several commenters requested guidance on amendment deadlines for pre-approved plans. The deadline for adopting a required amendment (as well as any integrally related amendment) to a pre-approved plan is set forth in section 15 of Rev. Proc. 2016-37, and varies depending on several factors, including the type of entity sponsoring the plan and the period used for the plan year. For example, under Rev. Proc. 2016-37, in the case of an employer with a calendar-year tax year that maintains a pre-approved plan with a calendar-year plan year and that chose to apply the new safe harbor expense for certain disasters in 2018, the deadline to adopt such an interim amendment for the new expense would be the tax-filing deadline (plus extensions) for 2018. The Treasury Department and IRS recognize that, for an employer using a pre-approved plan, the interim amendment deadline under Rev. Proc. 2016-37 that applies for an amendment to a plan provision that is integral to the qualification requirement that has been changed may be earlier than the interim amendment deadline for the required amendment. Accordingly, the Treasury Department and IRS are extending the deadline for an interim amendment related to the hardship distribution provisions. Under this extension, for an employer using a pre-approved plan, the interim amendment deadline for the required amendment to the hardship distribution provisions of the plan will also be the deadline for all amendments integrally related to the hardship distribution provi-

sions (rather than the earlier deadline that might otherwise apply under Rev. Proc. 2016-37 to those integrally related amendments). Thus, if the employer in the example in this paragraph were to implement the prohibition on suspensions effective for distributions made on or after January 1, 2020, the interim amendment deadline to add the new safe harbor expense would be the same as the deadline for the required amendment (that is, the tax-filing deadline (plus extensions) for 2020), even if the new safe harbor expense is effective in an earlier year.

Several commenters also requested guidance on the amendment deadlines for pre-approved and individually designed section 403(b) plans. Under Rev. Proc. 2017-18, 2017-5 I.R.B. 743, the remedial amendment deadline for a section 403(b) plan is March 31, 2020. The Treasury Department and IRS are considering providing for a later amendment deadline for the amendments relating to the final regulations in separate guidance.

Other Issues

Several commenters requested that the Internal Revenue Manual (IRM) be updated to reflect the new hardship distribution rules. The IRS intends to update the IRM to reflect the new rules in the final regulations after publication of the final regulations.

Two commenters asked whether a plan must include every one of the seven expenses in the §1.401(k)-1(d)(3)(ii)(B) list of deemed immediate and heavy financial needs and cover every individual described in the list (for example, a primary beneficiary under the plan, in the case of certain expenses) in order to be considered as using the safe harbor standards for hardship distributions. Under the IRS's pre-approved plan program for qualified plans, certain section 401(k) plans that provide for hardship distributions will not be approved unless the distributions are made under circumstances described in the safe harbor standards in the regulations under section 401(k). For this purpose, a plan making hardship distributions for some but not all the safe harbor expenses, or for expenses of some but not all the categories of individuals described in §1.401(k)-1(d)(3)(ii)(B), is

considered to be using the safe harbor standards for hardship distributions.

One commenter asked whether the proposed regulations' prohibition on suspensions of elective contributions and employee contributions applies to pre-approved section 403(b) plans in light of the fact that the IRS's rules for pre-approved section 403(b) plans require that a participant's elective deferrals be suspended for 6 months following a hardship distribution. The prohibition on suspensions is retained in the final regulations, and the rule applies to section 403(b) plans, including pre-approved section 403(b) plans.

Also, one commenter asked for relief relating to the notice requirements for safe harbor plans described in sections 401(k)(12) and 401(k)(13). Because a description of withdrawal provisions is required to be included in the notice provided to eligible employees (see §1.401(k)-3(d)(2)(ii)(G)), if a description of the new hardship withdrawal provisions was not already included in a notice, employees must be provided an updated notice reflecting the new hardship withdrawal provisions and must be given a reasonable opportunity to change their cash or deferred election. See section III.C of Notice 2016-16, 2016-7 I.R.B. 318, for the notice-timing and election-opportunity requirements with respect to mid-year amendments to safe harbor plans.

Special Analyses

These regulations are not subject to review under section 6(b) of Executive Order 12866 pursuant to the Memorandum of Agreement (April 11, 2018) between the Treasury Department and the Office of Management and Budget regarding review of tax regulations.

Pursuant to the Regulatory Flexibility Act (5 U.S.C. chapter 6), it is hereby certified that the collection of information in these regulations will not have a significant economic impact on a substantial number of small entities. This certification is based on the fact that employers with section 401(k) plans that permit hardship withdrawals must already maintain records relating to an employee's application for a hardship withdrawal, and the incremental cost

due to the new certification requirement in final regulations §1.401(k)-1(d)(3)(iii)(B)(2) will be minimal. In addition, some employers, including some small entities, use a hardship withdrawal procedure available under the existing regulations that requires an employee certification almost identical to that in the final regulations. Therefore, a regulatory flexibility analysis under the Regulatory Flexibility Act is not required. Pursuant to section 7805(f) of the Code, the notice of proposed rulemaking preceding these regulations was submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small businesses, and no comment was received.

Drafting Information

The principal author of these regulations is Roger Kuehnle of the Office of Associate Chief Counsel (Employee Benefits, Exempt Organizations, and Employment Taxes). However, other personnel from the IRS and Treasury Department participated in their development.

Statement of Availability of IRS Documents

The IRS notices, revenue procedures and other guidance cited in this preamble are published in the Internal Revenue Bulletin (or Cumulative Bulletin) and are available from the Superintendent of Documents, U.S. Government Publishing Office, Washington, DC 20402, or by visiting the IRS website at <http://www.irs.gov>.

List of Subjects in 26 CFR Part 1

Income taxes, Reporting and record-keeping requirements.

Adoption of Amendments to the Regulations

Accordingly, 26 CFR part 1 is amended as follows:

PART 1—INCOME TAXES

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

Authority: 26 U.S.C. 401(m)(9) and 26 U.S.C. 7805.

* * * * *

Par. 2. Section 1.401(k)-0 is amended under the heading §1.401(k)-1 by revising the entries for (d)(3)(ii) and (d)(3)(ii)(A) and (B), adding an entry for (d)(3)(ii)(C), revising the entries for (d)(3)(iii) and (d)(3)(iii)(A) and (B), adding an entry for (d)(3)(iii)(C), revising the entry for (d)(3)(iv), removing the entries for (d)(3)(iv)(A) through (F), revising the entry for (d)(3)(v), and adding the entries for (d)(3)(v)(A) through (C) to read as follows:

§1.401(k)-0 Table of contents.

* * * * *

§1.401(k)-1 Certain cash or deferred arrangements.

* * * * *

(d) * * *

(3) * * *

(ii) Immediate and heavy financial need.

(A) In general.

(B) Deemed immediate and heavy financial need.

(C) Primary beneficiary under the plan.

(iii) Distribution necessary to satisfy financial need.

(A) Distribution may not exceed amount of need.

(B) No alternative means reasonably available.

(C) Additional conditions.

(iv) Commissioner may expand standards.

(v) Applicability date.

(A) General rule.

(B) Options for earlier application.

(C) Certain rules optional in 2019.

* * * * *

Par. 3. Section 1.401(k)-1 is amended by:

1. Revising paragraphs (d)(1)(ii) and (iii) and adding new paragraph (d)(1)(iv).
2. Removing paragraph (d)(3)(ii) and redesignating paragraphs (d)(3)(iii), (iv), and (v) as paragraphs (d)(3)(ii), (iii), and (iv).
3. Revising newly redesignated paragraph (d)(3)(ii)(B) and adding new paragraph (d)(3)(ii)(C).
4. Revising newly redesignated paragraphs (d)(3)(iii) and (iv) and adding new paragraph (d)(3)(v).
5. In paragraph (d)(6), removing *Examples 3, 4, and 5*, redesignating *Example 6* as *Example 3*, and designating

Examples 1 through 3 as paragraphs (d)(6)(i) through (iii).

6. In newly designated paragraph (d)(6)(ii), redesignating paragraphs (d)(6)(ii)(i) and (ii) as paragraphs (d)(6)(ii)(A) and (B).

The additions and revisions read as follows:

§1.401(k)-1 Certain cash or deferred arrangements.

* * * * *

(d) * * *

(1) * * *

(ii) In the case of a profit-sharing, stock bonus or rural cooperative plan— (A) The employee's attainment of age 59 ½; or

(B) In accordance with section 401(k)(14), the employee's hardship;

(iii) In accordance with section 401(k)(10), the termination of the plan; or

(iv) In the case of a qualified reservist distribution defined in section 72(t)(2)(G) (iii), the date the reservist was ordered or called to active duty.

* * * * *

(3) * * *

(ii) * * *

(B) *Deemed immediate and heavy financial need.* A distribution is deemed to be made on account of an immediate and heavy financial need of the employee if the distribution is for—

(1) Expenses for (or necessary to obtain) medical care that would be deductible under section 213(d), determined without regard to the limitations in section 213(a) (relating to the applicable percentage of adjusted gross income and the recipients of the medical care) provided that, if the recipient of the medical care is not listed in section 213(a), the recipient is a primary beneficiary under the plan;

(2) Costs directly related to the purchase of a principal residence for the employee (excluding mortgage payments);

(3) Payment of tuition, related educational fees, and room and board expenses, for up to the next 12 months of post-secondary education for the employee, for the employee's spouse, child or dependent (as defined in section 152 without regard to section 152(b)(1), (b)(2) and (d)(1)(B)), or for a primary beneficiary under the plan;

(4) Payments necessary to prevent the eviction of the employee from the em-

ployee's principal residence or foreclosure on the mortgage on that residence;

(5) Payments for burial or funeral expenses for the employee's deceased parent, spouse, child or dependent (as defined in section 152 without regard to section 152(d)(1)(B)), or for a deceased primary beneficiary under the plan;

(6) Expenses for the repair of damage to the employee's principal residence that would qualify for the casualty deduction under section 165 (determined without regard to section 165(h)(5) and whether the loss exceeds 10% of adjusted gross income); or

(7) Expenses and losses (including loss of income) incurred by the employee on account of a disaster declared by the Federal Emergency Management Agency (FEMA) under the Robert T. Stafford Disaster Relief and Emergency Assistance Act, Pub. L. 100-707, provided that the employee's principal residence or principal place of employment at the time of the disaster was located in an area designated by FEMA for individual assistance with respect to the disaster.

(C) *Primary beneficiary under the plan.* For purposes of paragraph (d)(3)(ii)(B) of this section, a "primary beneficiary under the plan" is an individual who is named as a beneficiary under the plan and has an unconditional right, upon the death of the employee, to all or a portion of the employee's account balance under the plan.

(iii) *Distribution necessary to satisfy financial need—*(A) *Distribution may not exceed amount of need.* A distribution is treated as necessary to satisfy an immediate and heavy financial need of an employee only to the extent the amount of the distribution is not in excess of the amount required to satisfy the financial need (including any amounts necessary to pay any federal, state, or local income taxes or penalties reasonably anticipated to result from the distribution).

(B) *No alternative means reasonably available.* A distribution is not treated as necessary to satisfy an immediate and heavy financial need of an employee unless each of the following requirements is satisfied—

(1) The employee has obtained all other currently available distributions (including distributions of ESOP dividends

under section 404(k), but not hardship distributions) under the plan and all other plans of deferred compensation, whether qualified or nonqualified, maintained by the employer;

(2) The employee has provided to the plan administrator a representation in writing (including by using an electronic medium as defined in §1.401(a)-21(e)(3)), or in such other form as may be prescribed by the Commissioner, that he or she has insufficient cash or other liquid assets reasonably available to satisfy the need; and

(3) The plan administrator does not have actual knowledge that is contrary to the representation.

(C) *Additional conditions.* A plan generally may provide for additional conditions, such as those described in 26 CFR 1.401(k)-1(d)(3)(iv)(B) and (C) (revised as of April 1, 2019), to demonstrate that a distribution is necessary to satisfy an immediate and heavy financial need of an employee. For example, a plan may provide that, before a hardship distribution may be made, an employee must obtain all nontaxable loans (determined at the time a loan is made) available under the plan and all other plans maintained by the employer. However, a plan may not provide for a suspension of an employee's elective contributions or employee contributions under any plan described in section 401(a) or 403(a), any section 403(b) plan, or any eligible governmental plan described in §1.457-2(f) as a condition of obtaining a hardship distribution.

(iv) *Commissioner may expand standards.* The Commissioner may prescribe additional guidance of general applicability, published in the Internal Revenue Bulletin (see §601.601(d)(2) of this chapter), expanding the list of distributions deemed to be made on account of immediate and heavy financial needs and setting forth additional methods to demonstrate that a distribution is necessary to satisfy an immediate and heavy financial need.

(v) *Applicability date—(A) General rule.* Except as otherwise provided in this paragraph (d)(3)(v), the rules in this paragraph (d)(3) apply to distributions made on or after January 1, 2020.

For distributions made before January 1, 2020, the rules in 26 CFR 1.401(k)-1(d)(3) (revised as of April 1, 2019) apply.

(B) *Options for earlier application.* The rules in this paragraph (d)(3) may be applied to distributions made in plan years beginning after December 31, 2018, and the last sentence of paragraph (d)(3)(iii)(C) of this section (prohibiting the suspension of contributions as a condition of obtaining a hardship distribution) may be applied as of the first day of the first plan year beginning after December 31, 2018, even if the distribution was made in the prior plan year. Thus, for example, a calendar-year plan that provides for hardship distributions under the rules in 26 CFR 1.401(k)-1(d)(3)(iv)(E) (revised as of April 1, 2019) may be amended to provide that an employee who receives a hardship distribution in the second half of the 2018 plan year will be prohibited from making contributions only until January 1, 2019 (or may continue to provide that contributions will be suspended for the originally scheduled 6 months). In addition, paragraph (d)(3)(ii)(B) of this section (listing distributions deemed to be made on account of an immediate and heavy financial need) may be applied to distributions made on or after a date that is as early as January 1, 2018.

(C) *Certain rules optional in 2019.* If, in accordance with paragraph (d)(3)(v)(B) of this section, the rules in this paragraph (d)(3) are applied to distributions made before January 1, 2020, then the rules in paragraphs (d)(3)(iii)(B)(2) and (3) of this section (relating to an employee representation) and the last sentence of paragraph (d)(3)(iii)(C) of this section (prohibiting the suspension of contributions as a condition of obtaining a hardship distribution) may be disregarded with respect to such distributions.

* * * * *

Par. 4. Section 1.401(k)-3 is amended by:

1. Revising paragraph (c)(6)(v).
2. Removing the language “, and, in the case of a hardship distribution, suspends an employee's ability to make elective contributions for 6 months

in accordance with §1.401(k)-1(d)(3)(iv)(E)” in the fifth sentence in paragraph (c)(7), *Example 1(i)*.

3. Removing the second sentence in paragraph (j)(2)(iv).

The revision reads as follows:

§1.401(k)-3 Safe harbor requirements.

* * * * *

(c) * * *

(6) * * *

(v) *Restrictions due to limitations under the Internal Revenue Code.* A plan may limit the amount of elective contributions made by an eligible employee under a plan—

(A) Because of the limitations of section 402(g) or 415;

(B) Due to a suspension under section 414(u)(12)(B)(ii); or

(C) Because, on account of a hardship distribution made before January 1, 2020, an employee's ability to make elective contributions has been suspended for 6 months.

* * * * *

§1.401(k)-6 [Amended]

Par. 5. Section 1.401(k)-6 is amended by:

1. Removing the fourth sentence in paragraph (2) of the definition of *Eligible employee*.
2. Removing the language “, except as provided otherwise in §1.401(k)-1(c) and (d),” in the definitions of *Qualified matching contributions (QMACs)* and *Qualified nonelective contributions (QNECs)*.

Par. 6. Section 1.401(m)-3 is amended by revising paragraph (d)(6)(v) to read as follows:

§1.401(m)-3 Safe harbor requirements.

* * * * *

(d) * * *

(6) * * *

(v) *Restrictions due to limitations under the Internal Revenue Code.* A plan may limit the amount of contributions made by an eligible employee under a plan—

- (A) Because of the limitations of section 402(g) or section 415;
- (B) Due to a suspension under section 414(u)(12)(B)(ii); or
- (C) Because, on account of a hardship distribution made before January 1, 2020, an employee's ability to make contributions has been suspended for 6 months.

* * * * *

Kirsten Wielobob,
*Deputy Commissioner for Services
and Enforcement.*

David J. Kautter,
*Assistant Secretary of the Treasury
(Tax Policy).*

Approved: September 5, 2019.

(Filed by the Office of the Federal Register on September 19, 2019, 4:15 p.m., and published in the issue of the Federal Register for September 23, 2019, 84 F.R. 49651)

Part III.

Update for Weighted Average Interest Rates, Yield Curves, and Segment Rates

Notice 2019-51

This notice provides guidance on the corporate bond monthly yield curve, the corresponding spot segment rates used under § 417(e)(3), and the 24-month average segment rates under § 430(h)(2) of the Internal Revenue Code. In addition, this notice provides guidance as to the interest rate on 30-year Treasury securities under § 417(e)(3)(A)(ii)(II) as in effect for plan years beginning before 2008 and the 30-year Treasury weighted average rate under § 431(c)(6)(E)(ii)(I).

YIELD CURVE AND SEGMENT RATES

Section 430 specifies the minimum funding requirements that apply to single-employer plans (except for CSEC plans under § 414(y)) pursuant to § 412. Section 430(h)(2) specifies the inter-

est rates that must be used to determine a plan's target normal cost and funding target. Under this provision, present value is generally determined using three 24-month average interest rates ("segment rates"), each of which applies to cash flows during specified periods. To the extent provided under § 430(h)(2)(C)(iv), these segment rates are adjusted by the applicable percentage of the 25-year average segment rates for the period ending September 30 of the year preceding the calendar year in which the plan year begins.¹ However, an election may be made under § 430(h)(2)(D)(ii) to use the monthly yield curve in place of the segment rates.

Notice 2007-81, 2007-44 I.R.B. 899, provides guidelines for determining the monthly corporate bond yield curve, and the 24-month average corporate bond segment rates used to compute the target normal cost and the funding target. Consistent with the methodology specified in Notice 2007-81, the monthly corporate bond yield curve derived from August 2019 data is in Table 2019-8 at the end of this notice. The spot first, second, and third segment rates for the month of August 2019 are, respectively, 2.09, 3.00, and 3.61.

The 24-month average segment rates determined under § 430(h)(2)(C)(i) through (iii) must be adjusted pursuant to § 430(h)(2)(C)(iv) to be within the applicable minimum and maximum percentages of the corresponding 25-year average segment rates. For plan years beginning before 2021, the applicable minimum percentage is 90% and the applicable maximum percentage is 110%. The 25-year average segment rates for plan years beginning in 2018 and 2019 were published in Notice 2017-50, 2017-41 I.R.B. 280, and Notice 2018-73, 2018-40 I.R.B. 526, respectively. For plan years beginning in 2020, based on the segment rates applicable for October 1994 to September 2019, the 25-year averages for the period ending September 30, 2019, of the first, second, and third segment rates are 4.04, 5.79, and 6.60 percent, respectively.

24-MONTH AVERAGE CORPORATE BOND SEGMENT RATES

The three 24-month average corporate bond segment rates applicable for September 2019 without adjustment for the 25-year average segment rate limits are as follows:

24-Month Average Segment Rates Without 25-Year Average Adjustment			
Applicable Month	First Segment	Second Segment	Third Segment
September 2019	2.79	3.92	4.38

Based on § 430(h)(2)(C)(iv), the 24-month averages applicable for Sep-

tember 2019, adjusted to be within the applicable minimum and maximum percent-

ages of the corresponding 25-year average segment rates, are as follows:

Adjusted 24-Month Average Segment Rates				
For Plan Years Beginning In	Applicable Month	First Segment	Second Segment	Third Segment
2018	September 2019	3.92	5.52	6.29
2019	September 2019	3.74	5.35	6.11
2020	September 2019	3.64	5.21	5.94

30-YEAR TREASURY SECURITIES INTEREST RATES

Section 431 specifies the minimum funding requirements that apply to mul-

tiemployer plans pursuant to § 412. Section 431(c)(6)(B) specifies a minimum amount for the full-funding limitation described in § 431(c)(6)(A), based on the plan's current liability. Section 431(c)(6)

(E)(ii)(I) provides that the interest rate used to calculate current liability for this purpose must be no more than 5 percent above and no more than 10 percent below the weighted average of the rates of inter-

¹Pursuant to § 433(h)(3)(A), the 3rd segment rate determined under § 430(h)(2)(C) is used to determine the current liability of a CSEC plan (which is used to calculate the minimum amount of the full funding limitation under § 433(c)(7)(C)).

est on 30-year Treasury securities during the four-year period ending on the last day before the beginning of the plan year. Notice 88-73, 1988-2 C.B. 383, provides guidelines for determining the weighted average interest rate. The rate of interest on 30-year Treasury securities for Au-

gust 2019 is 2.12 percent. The Service determined this rate as the average of the daily determinations of yield on the 30-year Treasury bond maturing in May 2049 determined each day through August 7, 2019 and the yield on the 30-year Treasury bond maturing in August 2049

determined each day for the balance of the month. For plan years beginning in September 2019, the weighted average of the rates of interest on 30-year Treasury securities and the permissible range of rates used to calculate current liability are as follows:

<i>Treasury Weighted Average Rates</i>		
For Plan Years Beginning In	30-Year Treasury Weighted Average	Permissible Range
September 2019	2.90	90% to 105% 2.61 to 3.04

MINIMUM PRESENT VALUE SEGMENT RATES

In general, the applicable interest rates

under § 417(e)(3)(D) are segment rates computed without regard to a 24-month average. Notice 2007-81 provides guidelines for determining the minimum pres-

ent value segment rates. Pursuant to that notice, the minimum present value segment rates determined for August 2019 are as follows:

<i>Minimum Present Value Segment Rates</i>			
Month	First Segment	Second Segment	Third Segment
August 2019	2.09	3.00	3.61

DRAFTING INFORMATION

The principal author of this notice is Tom Morgan of the Office of the Asso-

ciate Chief Counsel (Employee Benefits, Exempt Organizations, and Employment Taxes). However, other personnel from the IRS participated in the development

of this guidance. For further information regarding this notice, contact Mr. Morgan at 202-317-6700 or Paul Stern at 202-317-8702 (not toll-free numbers).

Table 2019-8
 Monthly Yield Curve for August 2019
 Derived from August 2019 Data

Maturity	Yield								
0.5	2.09	20.5	3.43	40.5	3.63	60.5	3.71	80.5	3.74
1.0	2.09	21.0	3.44	41.0	3.64	61.0	3.71	81.0	3.74
1.5	2.09	21.5	3.45	41.5	3.64	61.5	3.71	81.5	3.74
2.0	2.08	22.0	3.46	42.0	3.64	62.0	3.71	82.0	3.74
2.5	2.07	22.5	3.47	42.5	3.64	62.5	3.71	82.5	3.74
3.0	2.07	23.0	3.47	43.0	3.65	63.0	3.71	83.0	3.75
3.5	2.07	23.5	3.48	43.5	3.65	63.5	3.71	83.5	3.75
4.0	2.09	24.0	3.49	44.0	3.65	64.0	3.71	84.0	3.75
4.5	2.12	24.5	3.50	44.5	3.65	64.5	3.71	84.5	3.75
5.0	2.16	25.0	3.50	45.0	3.66	65.0	3.72	85.0	3.75
5.5	2.21	25.5	3.51	45.5	3.66	65.5	3.72	85.5	3.75
6.0	2.27	26.0	3.51	46.0	3.66	66.0	3.72	86.0	3.75
6.5	2.34	26.5	3.52	46.5	3.66	66.5	3.72	86.5	3.75
7.0	2.42	27.0	3.53	47.0	3.66	67.0	3.72	87.0	3.75
7.5	2.49	27.5	3.53	47.5	3.67	67.5	3.72	87.5	3.75
8.0	2.57	28.0	3.54	48.0	3.67	68.0	3.72	88.0	3.75
8.5	2.64	28.5	3.54	48.5	3.67	68.5	3.72	88.5	3.75
9.0	2.71	29.0	3.55	49.0	3.67	69.0	3.72	89.0	3.75
9.5	2.78	29.5	3.55	49.5	3.67	69.5	3.72	89.5	3.75
10.0	2.85	30.0	3.56	50.0	3.68	70.0	3.73	90.0	3.75
10.5	2.91	30.5	3.56	50.5	3.68	70.5	3.73	90.5	3.75
11.0	2.96	31.0	3.57	51.0	3.68	71.0	3.73	91.0	3.75
11.5	3.02	31.5	3.57	51.5	3.68	71.5	3.73	91.5	3.75
12.0	3.06	32.0	3.58	52.0	3.68	72.0	3.73	92.0	3.76
12.5	3.11	32.5	3.58	52.5	3.68	72.5	3.73	92.5	3.76
13.0	3.15	33.0	3.59	53.0	3.69	73.0	3.73	93.0	3.76
13.5	3.18	33.5	3.59	53.5	3.69	73.5	3.73	93.5	3.76
14.0	3.21	34.0	3.59	54.0	3.69	74.0	3.73	94.0	3.76
14.5	3.24	34.5	3.60	54.5	3.69	74.5	3.73	94.5	3.76
15.0	3.27	35.0	3.60	55.0	3.69	75.0	3.73	95.0	3.76
15.5	3.29	35.5	3.60	55.5	3.69	75.5	3.73	95.5	3.76
16.0	3.31	36.0	3.61	56.0	3.69	76.0	3.74	96.0	3.76
16.5	3.33	36.5	3.61	56.5	3.70	76.5	3.74	96.5	3.76
17.0	3.35	37.0	3.61	57.0	3.70	77.0	3.74	97.0	3.76
17.5	3.36	37.5	3.62	57.5	3.70	77.5	3.74	97.5	3.76
18.0	3.38	38.0	3.62	58.0	3.70	78.0	3.74	98.0	3.76
18.5	3.39	38.5	3.62	58.5	3.70	78.5	3.74	98.5	3.76
19.0	3.40	39.0	3.63	59.0	3.70	79.0	3.74	99.0	3.76
19.5	3.41	39.5	3.63	59.5	3.70	79.5	3.74	99.5	3.76
20.0	3.42	40.0	3.63	60.0	3.70	80.0	3.74	100.0	3.76

Low-Income Housing Credit Disaster Relief for the State of California

Notice 2019-52

I. PURPOSE

In response to the devastation caused by the California Wildfires to Butte, Los Angeles, and Ventura Counties in the State of California (hereinafter, California), this notice expands the emergency housing and compliance monitoring relief that is provided in Rev. Proc. 2014-49, 2014-37 I.R.B. 535, and Rev. Proc. 2014-50, 2014-37 I.R.B. 540. The expanded relief in this notice is limited to the CA Wildfires Major Disaster, as defined below. Except as expressly provided in this notice, all provisions of Rev. Procs. 2014-49 and 2014-50 apply to the CA Wildfires Major Disaster without modification. For example, this notice does not modify the carryover allocation relief provisions of Rev. Proc. 2014-49, because the only low-income housing project damaged or destroyed by the wildfire had been placed in service before the disaster.

This notice also solicits public comments regarding any desirable modifications to Rev. Procs. 2014-49 and 2014-50.

II. BACKGROUND

Rev. Procs. 2014-49 and 2014-50 provide temporary relief from certain requirements of §§ 42 and 142(d) of the Internal Revenue Code in the context of a major disaster. Rev. Proc. 2014-49 provides guidance and relief to the owners of qualified low-income housing projects (each such project, a § 42 Project) and to Agencies (as defined in section 5.01 of Rev. Proc. 2014-49) that are responsible for those § 42 Projects. Rev. Proc. 2014-50 provides guidance to issuers of exempt facility bonds financing qualified residential rental projects under § 142(d) (each such issuer, an Issuer; each such project, a § 142(d) Project) and to operators of those § 142(d) Projects. Various aspects of these revenue procedures apply with respect to § 42 Projects and § 142(d) Projects both inside and outside of the area in which the major disaster occurs.

Sections 12 through 14 of Rev. Proc. 2014-49 and sections 5 through 7 of Rev. Proc. 2014-50 facilitate emergency housing relief for Displaced Individuals (as defined in section 5.02 of Rev. Proc. 2014-49 and in section 4.04 of Rev. Proc. 2014-50). To achieve this end, these sections give owners of § 42 Projects and operators of § 142(d) Projects the option to apply certain modifications to the rules of §§ 42 and 142(d), provided that the relevant Agency or Issuer authorizes the owner or operator to do so. Among these modifications is the ability to disregard the actual income of a Displaced Individual housed in a § 42 Project or a § 142(d) Project, even if the Displaced Individual's income exceeds the limitations on income provided in §§ 42 or 142(d). The option to apply these modified rules is limited to a period defined in the revenue procedures as the Temporary Housing Period. *See* section 5.08 of Rev. Proc. 2014-49 and section 4.13 of Rev. Proc. 2014-50. The Temporary Housing Period begins on the first day of the incident period, as determined by the Federal Emergency Management Agency (FEMA), and ends on a date determined by the Agency or Issuer. Both revenue procedures provide a date beyond which the Temporary Housing Period may not extend. *See* section 12.02(1) of Rev. Proc. 2014-49 and section 5.02(1) of Rev. Proc. 2014-50.

On November 12, 2018, under the authority of the Robert T. Stafford Disaster Relief and Emergency Assistance Act, 42 U.S.C. §§ 5121-5206 (the Stafford Act), the President of the United States issued a major disaster declaration with respect to the damage in California caused by wildfires beginning on November 8, 2018, and FEMA designated three counties (Butte, Los Angeles, and Ventura Counties) within California to be eligible for Individual Assistance and Public Assistance under the Stafford Act (CA Wildfires Major Disaster). *See* 83 Fed. Reg. 64352 (2018). The incident period for the CA Wildfires Major Disaster began on November 8, 2018, and closed on November 25, 2018. *See* 83 Fed. Reg. 63553 (2018).

Agencies must periodically review § 42 Projects for compliance with the affordability and habitability requirements of § 42. *See* § 42(m)(1)(B)(iii); *see also* § 1.42-5 of the Income Tax Regulations.

Under section 9 of Rev. Proc. 2014-49, an Agency may extend the due date for its scheduled compliance reviews for up to one calendar year from the date of a low-income building's restoration and placement again into service. That revenue procedure does not delay the compliance review due dates of buildings that do not require restoration and replacement into service.

III. EMERGENCY HOUSING RELIEF

Solely in connection with the CA Wildfires Major Disaster, the second sentence of section 12.02(1) in Rev. Proc. 2014-49 and the second sentence of section 5.02(1) in Rev. Proc. 2014-50 are revised to read: "The Temporary Housing Period cannot extend beyond the end of July 2020."

IV. COMPLIANCE MONITORING RELIEF

Under this notice, the California Tax Credit Allocation Committee (CTCAC) may extend the date for its compliance review of low-income housing projects notwithstanding section 9 of Rev. Proc. 2014-49. For any such building, this extension may not last beyond one calendar year from the later of—

- November 25, 2018; or
- In the case of a building that has suffered a casualty loss due to the CA Wildfires Major Disaster or has been completely taken out of service due to the CA Wildfires Major Disaster, the date of the building's restoration and placement again in service.

This extension of dates for compliance review by the CTCAC does not, however, extend the compliance monitoring deadlines for owners or operators. If the CTCAC learns that an owner or operator has failed to comply with the rules of § 42, as applicable, the noncompliance must be reported timely to the Internal Revenue Service (Service), along with a description of whether and how the wildfires contributed to the noncompliance.

**V. REQUEST FOR COMMENTS
REGARDING POSSIBLE
MODIFICATIONS TO REVENUE
PROCEDURES 2014-49 AND 2014-50**

The Department of the Treasury and the Service are considering whether to make any changes to Rev. Procs. 2014-49 and 2014-50, and, in that regard, request comments from the public regarding possible changes to the two revenue procedures. Comments should be submitted by October 31, 2019. Comments may be mailed to:

Internal Revenue Service
Attn: CC:PA:LPD:PR (Notice 2019-
52)

Room 5203
P.O. Box 7604
Ben Franklin Station
Washington, D.C. 20044

or hand delivered Monday through Friday between the hours of 8 a.m. and 4 p.m. to:

Courier's Desk
Internal Revenue Service
Attn: CC:PA:LPD:PR (Notice 2019-
52)
1111 Constitution Avenue, N.W.
Washington, D.C. 20224

Alternatively, persons may submit comments electronically via e-mail to the following address:

Notice.Comments@irs counsel.treas.gov

Persons should include "Notice 2019-52" in the subject line. All comments submitted will be available for public inspection and copying in their entirety.

VI. DRAFTING INFORMATION

The principal author of this notice is Michael J. Torruella Costa of the Office of Associate Chief Counsel (Passthroughs & Special Industries). For further information regarding this notice contact Michael J. Torruella Costa on (202) 317-4137 (not a toll-free number).

NOTE. This revenue procedure will be reproduced as the next revision of IRS Publication 1167, General Rules and Specifications for Substitute Forms and Schedules.

Rev. Proc. 2019-35

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Part 1
Introduction to Substitute Forms

Section 1.1 – Overview of Revenue Procedure 2019-35

**1.1.1
Purpose**

The purpose of this revenue procedure is to provide guidelines and general requirements for the development, printing, and approval of the 2019 substitute tax forms. Approval will be based on these guidelines. After review and approval, submitted forms will be accepted as substitutes for official IRS forms.

**1.1.2
Unique Forms**

Certain unique specialized forms require the use of other additional publications to supplement this publication. See *Part 4*.

**1.1.3
Scope**

The IRS accepts quality substitute tax forms that are consistent with the official forms and have no adverse impact on processing. The IRS Substitute Forms Program (the Program) administers the formal acceptance and processing of these forms nationwide. While this Program deals with paper documents, it also reviews for approval other processing and filing forms used in electronic filing.

Only those substitute forms that comply fully with these requirements are acceptable. This revenue procedure is updated as required to reflect pertinent tax year form changes and to meet processing and/or legislative requirements.

**1.1.4
Forms Covered
by This Revenue
Procedure**

The following types of forms are covered by this revenue procedure.

- IRS tax forms and their related schedules.
 - Worksheets as they appear in instruction packages.
 - Applications for permission to file returns electronically and forms used as required documentation for electronically filed returns.
 - Powers of Attorney.
 - Over-the-counter estimated tax payment vouchers.
 - Forms and schedules relating to partnerships, exempt organizations, and employee plans.
-

**1.1.5
Forms Not Covered
by This Revenue
Procedure**

The following types of forms are not covered by this revenue procedure.

- W-2 and W-3 (see Pub. 1141 for information on these forms).

- W-2c and W-3c (see Pub. 1223 for information on these forms).
 - 941, Schedule B (Form 941), Schedule D (Form 941), Schedule R (Form 941), and 8974 (see Pub. 4436 for information on these forms).
 - 1096, 1097-BTC, 1098 series, 1099 series, 3921, 3922, 5498 series, W-2G, 1042-S (see Pub. 1179 for information on these forms).
 - 1095-A, 1094-B, 1095-B, 1094-C, and 1095-C (see Pub. 5223 for information on these forms).
 - 8027 (see Pub. 1239 for information on this form).
 - Forms 1040-ES (OCR) and 1041-ES (OCR), which may not be reproduced.
 - Forms 5500 (for more information on these forms, see the Department of Labor website at www.efast.dol.gov).
 - Forms 5300, 5307, 8717, and 8905, bar-coded forms requiring separate approval.
 - Forms used internally by the IRS.
 - State tax forms.
 - Forms developed outside the IRS.
-

**1.1.6
Other Information
Not Covered by This
Revenue Procedure**

The following information is not covered by this revenue procedure.

- Requests for information or documentation initiated by the IRS.
 - General Instructions and Specific Instructions (these are not reviewed by the Program).
-

Section 1.2 – IRS Contacts

**1.2.1
Where To Send
Substitute Forms**

Send your substitute forms for **approval** to the following offices (do not send forms with taxpayer data).

Form	Office and Address
5500	Check EFAST2 information at the Department of Labor website at www.efast.dol.gov
5300, 5307, 8717, and 8905	<i>Sandra.K.Barnes@irs.gov</i>
Software developer vouchers (see <i>Sections 2.3.7–2.3.9</i>)	Internal Revenue Service Attn: Doris Bethea 5000 Ellin Road, C5-226 Lanham, MD 20706 <i>Doris.E.Bethea@irs.gov</i>

Form	Office and Address
ACA Forms 1094-B, 1095-B, 1094-C, and 1095-C (for more information, see Pub. 5223), and Schedule K-1 forms must be emailed for scanability testing	<i>scrips@irs.gov</i>
Schedule K-1 2-D bar-coded forms	For mailing addresses for sending Schedule K-1 2-D bar-coded forms for testing, see <i>Section 7.1.6</i>
All others covered by this publication (see <i>Section 1.1.4</i>)	Internal Revenue Service Attn: Substitute Forms Program SE:W:CAR:MP:P:TP 1111 Constitution Ave. NW, Room 6554 Washington, DC 20224 <i>substituteforms@irs.gov</i>

For questions about:

- Forms W-2 and W-3, refer to Pub. 1141, General Rules and Specifications for Substitute Forms W-2 and W-3;
- Forms W-2c and W-3c, refer to Pub. 1223, General Rules and Specifications for Substitute Forms W-2c and W-3c;
- Form 941 and Schedules B, D, and R, as well as Form 8974, refer to Pub. 4436, General Rules and Specifications for Substitute Form 941, Schedule B (Form 941), Schedule D (Form 941), Schedule R (Form 941), and Form 8974;
- Forms 1096, 1097-BTC, 1098, 1099, 3921, 3922, 5498, W-2G, and 1042-S, refer to Pub. 1179, General Rules and Specifications for Substitute Forms 1096, 1098, 1099, 5498, and Certain Other Information Returns;
- Forms 1095-A, 1094-B, 1095-B, 1094-C, and 1095-C, refer to Pub. 5223, General Rules and Specifications for Affordable Care Act Substitute Forms 1095-A, 1094-B, 1095-B, 1094-C, and 1095-C; and
- Form 8027, refer to Pub. 1239, Specifications for Electronic Filing of Form 8027, Employer's Annual Information Return of Tip Income and Allocated Tips.

Section 1.3 – What's New

1.3.1

What's New

The following changes have been made to this year's revenue procedure.

- **.01 Editorial changes.** We made editorial changes throughout and redundancies were eliminated as much as possible.
- **.02 Form 1040-SR.** Form 1040-SR, U.S. Tax Return for Seniors, is new for tax year 2019. This form is essentially the same as Form 1040 and anyone who files Form 1040-SR is considered to have filed a Form 1040. We added references to Form 1040-SR throughout this revenue procedure.

- **.03 Cents entry fields.** In most cases, the vertical rule that previously separated dollars from cents has been removed from income tax returns and schedules. Entries can still be made in dollars and cents by entering a decimal point after the dollar amount.
 - **.04 Combining Form 1040 pages 1 and 2.** You can no longer combine pages 1 and 2 of Form 1040 onto a single page because the number of lines on the 2019 Form 1040 increased from the prior year. This exception to the general rules was previously discussed in section 5.1.1 and Exhibit A of Revenue Procedure 2018-51.
-

Section 1.4 – Definitions

1.4.1 Substitute Form	A tax form (or related schedule) that differs in any way from the official version and is intended to replace the form that is printed and distributed by the IRS. This term also covers those approved substitute forms exhibited in this revenue procedure.
1.4.2 Printed/ Preprinted Form	A form produced using conventional printing processes or a printed form which has been reproduced by photocopying or a similar process.
1.4.3 Preprinted Pin-Fed Form	A printed form that has marginal perforations for use with automated and high-speed printing equipment.
1.4.4 Computer- Prepared Substitute Form	A preprinted form in which the taxpayer's tax entry information has been inserted by a computer, computer printer, or other computer-type equipment.
1.4.5 Computer- Generated Substitute Tax Return or Form	A tax return or form that is entirely designed and printed using a computer printer on plain white paper. This return or form must conform to the physical layout of the corresponding IRS form, although the typeface may differ. The text should match the text on the officially printed form as closely as possible. Condensed text and abbreviations will be considered on a case-by-case basis. Exception. All jurats (perjury statements) must be reproduced verbatim.
1.4.6 Manually Prepared Form	A preprinted reproduced form in which the taxpayer's tax entry information is entered by an individual using a pen, pencil, typewriter, or other nonautomated equipment.

**1.4.7
Graphics**

Parts of a printed tax form that are not tax amount entries or required text. Examples of graphics are line numbers, captions, shadings, special indicators, borders, rules, and strokes created by typesetting, photographics, photocomposition, etc.

**1.4.8
Acceptable
Reproduced Form**

A legible photocopy or an exact replica of an original form.

**1.4.9
Supporting
Statement
(Supplemental
Schedule)**

A document providing detailed information to support a line entry on an official or approved substitute form and filed with (attached to) a tax return.

Note. A supporting statement is not a tax form and does not take the place of an official form.

**1.4.10
Specific Form Terms**

The following specific terms are used throughout this revenue procedure in reference to all substitute forms: format, sequence, line reference, item caption, and data entry field.

**1.4.11
Format**

The overall physical arrangement and general layout of a substitute form.

**1.4.12
Sequence**

Sequence is an integral part of the total format requirement. The substitute form should show the same numeric and logical placement order of data as shown on the official form.

**1.4.13
Line Reference**

The line numbers, letters, or alphanumerics used to identify each captioned line on an official form. These line references are printed to the immediate left of each caption and/or data entry field.

**1.4.14
Item Caption**

The text on each line of a form, which identifies the data required.

**1.4.15
Data Entry Field**

Designated areas for the entry of data such as dollar amounts, quantities, responses, and check-boxes.

**1.4.16
Advance Draft**

A draft version of a new or revised form may be posted to the IRS website (*IRS.gov/DraftForms*) for information purposes. Substitute forms may be submitted based on these advance drafts, but any submitter that receives forms approval based on these early drafts is responsible for monitoring and revising forms to mirror any revisions in the final forms provided by the IRS.

**1.4.17
Approval**

Generally, approval could be in writing or assumed after 20 business days from our receipt for forms that have not been substantially changed by the IRS. This does not apply to newly created or substantially revised IRS forms. However, the Program reserves the right to notify vendors of any inaccuracies even after 20 business days have lapsed.

**1.4.18
National Association
of Computerized
Tax Processors
(NACTP)**

The National Association of Computerized Tax Processors (NACTP) is a nonprofit association that represents tax processing software and hardware developers, electronic filing processors, tax form publishers, tax processing service bureaus, and payroll processors. The association promotes standards in tax processing to advance efficient and effective tax filing. For more information, see *NACTP.org*.

Section 1.5 – Agreement

**1.5.1
Important
Stipulation of This
Revenue Procedure**

Any person or company who uses substitute forms and makes all or part of the changes specified in this revenue procedure agrees to the following stipulations.

- The IRS presumes that any required changes are made in accordance with these procedures and will not be disruptive to the processing of the tax return.
 - Should any of the changes be disruptive to the IRS's processing of the tax return, the person or company agrees to accept the determination of the IRS as to whether the form may continue to be filed.
 - The person or company agrees to work with the IRS in correcting noted deficiencies. Notification of deficiencies may be made by any combination of letter, email, or phone contact and may include the request for the resubmission of unacceptable forms.
-

**1.5.2
Response Policy and
Stipulations**

The Program will email confirmation of receipt of your forms submission, if possible. Even if you do not receive emailed confirmation of receipt, you will receive an emailed "submission receipt," which will provide feedback on your submission. If the Program anticipates problems in completing the review of your submission within the 20-business-day period, the Program will send an interim email notifying you of the extended period for review.

Once the substitute forms have been approved by the Program, you can release them after the final versions of the forms have been issued by the IRS. Before releasing the forms, you are responsible for updating forms approved as draft and for making form changes we requested.

The policy has the following stipulations.

- This 20-business-day policy applies to electronic submissions only. It does not apply to substitute submissions mailed to the Program.
- The policy applies to submissions of 15 (optimal) or fewer items and submissions containing 75 pages or less. Submissions of more than 15 items may require additional review time.
- If you send a large number of submissions within a short period of time, processing may be delayed.
- Delays in processing could occur if the Program finds significant errors in your submission or has experienced an increase in submissions. The Program will send you an interim email in this case.
- Any anticipated problems in processing your submission within the 20-business-day period will generate an interim email on or about the 15th business day.
- If any significant inaccuracies are discovered after the 20-business-day period, the Program reserves the right to inform you and will require that changes be made to correct the inaccuracies.
- The policy does not apply to substantially revised forms or to new forms created by the IRS for which you have already made an initial submission.

Part 2 **General Guidelines for Submissions and Approvals**

Section 2.1 – General Specifications for Approval

2.1.1 Overview

If you produce any substitute tax forms that fully comply or follow the changes specifically outlined by the Program, then you can generate your own substitute forms without further approval. Also, if your substitutes have received approval in the past, and there are no substantial formatting or text changes for the tax year, then changes can be made without additional approval. If your changes are more extensive, you must get IRS approval before using substitute forms. More extensive changes include different font style, decreasing or increasing the font size of caption titles, adjusting or omitting format/layout elements, changing page orientation, repositioning line items, tables, and legends.

2.1.2 Email Submissions

The Program accepts submissions of substitute forms for review and approval via email. The email address is *substituteforms@irs.gov*. Please include the term “PDF Submissions” on the subject line.

Follow these guidelines.

- Email submission should include all the forms you wish to submit in one Portable Document Format (PDF) file. Do not email or attach each form individually.

- The emailed submission should include a maximum of 3 PDFs to include: a checksheet, a cover letter or accompanying statement, and a single PDF that includes all of the forms listed on your checksheet, cover letter, or accompanying statement.
- A submission should contain a maximum of 15 forms.
- An approval checksheet listing the forms you are submitting should always be included in the PDF file along with the forms. Excluding the checksheet can slow the reviewing process down, which can result in a delayed response to your submission. See a sample checksheet in *Exhibit B*.
- Optimize PDF files before submitting.
- The maximum allowable email attachment is 2.5 megabytes.
- The Program accepts zip files.
- To alleviate delays during the peak time of September through December, submit advance draft forms as early as possible.

If the guidelines are not followed, you may need to resubmit.

Emailing PDF submissions will not expedite review and approval. Submitting your substitute forms package via email is the preferred and suggested method for submitting forms for review. If, for some reason, you are not able to email your submission(s), you can mail your submission(s) to:

Internal Revenue Service
Attn: Substitute Forms Program
SE:W:CAR:MP:P:TP
1111 Constitution Ave. NW, Room 6554
Washington, DC 20224

2.1.3 Expediting the Process

Follow these basic guidelines for expediting the process.

- Always include a checksheet for the Program's response.
 - Include an accompanying statement identifying most, if not all, of the deviations your substitute forms may include which the official IRS version of the form does not.
 - Follow the guidance in this publication for general substitute form guidelines. Follow the guidance in specialized publications produced by the Program for other specific forms.
 - To spread out the workload, send in draft versions of substitute forms when they are posted. **Note.** Be sure to make any changes to approved drafts before releasing final versions.
-

2.1.4 Schedules

Schedules are considered to be an integral part of a complete tax return. A schedule may be included as part of a form or printed separately.

**2.1.5
Examples of
Schedules That
Must Be Submitted
With the Return**

Form 706, United States Estate (and Generation-Skipping Transfer) Tax Return, is an example of this situation. Its Schedules A through U have pages numbered as part of the basic return. For Form 706 to be considered for approval, the entire form, including Schedules A through U, as well as Schedule PC, must be submitted.

**2.1.6
Examples of
Schedules That
Can Be Submitted
Separately**

Schedules C, D, and E for Form 1040 or 1040-SR are examples of schedules that can be submitted separately. Although printed by the IRS as a supplement to Form 1040 and 1040-SR, none of these schedules are required to be filed with Form 1040 or 1040-SR. These schedules may be separated from Form 1040 or 1040-SR and submitted as substitute forms.

**2.1.7
Use and Distribution
of Unapproved
Forms**

The IRS is continuing a program to identify and contact tax return preparers, forms developers, and software publishers who use or distribute unapproved forms that do not conform to this revenue procedure. The use of unapproved forms hinders the processing of the returns.

Section 2.2 – Highlights of Permitted Changes and Requirements

**2.2.1
Methods of
Reproducing IRS
Forms**

There are methods of reproducing IRS printed tax forms suitable for use as substitutes without prior approval.

- You can photocopy most tax forms and use them instead of the official ones. The entire substitute form, including entries, must be legible.
- You can reproduce any current tax form as cut sheets, snap sets, and marginally punched, pin-fed forms as long as you use an official IRS version as the master copy.
- You can reproduce a form that requires a signature as a valid substitute form. Many tax forms (including returns) have a taxpayer signature requirement as part of the form layout. The jurat/jury statement/signature line areas must be retained and worded exactly as on the official form. The requirement for a signature, by itself, does not prohibit a tax form from being properly computer generated.

Section 2.3 – Vouchers

**2.3.1
Overview**

All payment vouchers (Forms 940-V, 941-V, 943-V, 944-V, 945-V, 1040-ES, 1040-V, 1041-V, and 2290-V) must be reproduced in conjunction with their forms. Substitute vouchers must be the same size as the officially printed vouchers. Vouchers that are prepared for printing on a laser printer may include a scan line.

**2.3.2
Scan Line
Specifications**

	NNNNNNNNN	AA	XXXX	NN	N	NNNNNN	NNN
Item:	A	B	C	D	E	F	G
A.	Social Security Number/Employer Identification Number (SSN/EIN) has 9 numeric (N) spaces.						
B.	Check Digits have 2 alpha (A) spaces .						
C.	Name Control has 4 alphanumeric (X) spaces.						
D.	Master File Tax (MFT) Code has 2 numeric (N) spaces (see <i>Section 2.3.3</i>).						
E.	Taxpayer Identification Number (TIN) Type has 1 numeric (N) space (see <i>Section 2.3.4</i>).						
F.	Tax Period has 6 numeric (N) spaces in year/month format (YYYYMM).						
G.	Transaction Code has 3 numeric (N) spaces.						

**2.3.3
MFT Code**

Code Number for Forms:

- 1040 (family) – 30,
- 940 – 10,
- 941 – 01,
- 943 – 11,
- 944 – 14,
- 945 – 16,
- 1041-V – 05,
- 2290 – 60, and
- 4868 – 30.

**2.3.4
TIN Type**

Type Number for:

- Form 1040 (family), 4868 – 0 and
- Forms 940, 941, 943, 944, 945, 1041-V, and 2290 – 2.

**2.3.5
Voucher Size**

The voucher size must be exactly 8.0" x 3.25" (Forms 1040-ES and 1041-ES must be 7.625" x 3.0"). The document scan line must be vertically positioned 0.25 inches from the bottom of the scan line to the bottom of the voucher. The last character on the right of the scan line must be placed 3.5 inches from the right leading edge of the document. The minimum required horizontal clear space between characters is 0.014 inches. The line to be scanned must have a clear band 0.25 inches in height from top to bottom of the scan line, and from border to border of the document. "Clear band" means no printing except for dropout ink.

2.3.6 Print and Paper Weight

Vouchers must be imaged in black ink using OCR A, OCR B, or Courier 10. These fonts may not be mixed in the scan line. The horizontal character pitch is 10 CPI. The preferred paper weight is 20 to 24 pound OCR bond.

2.3.7 Specifications for Software Developers

Certain vouchers may be reproduced for use in the IRS lockbox system. These include the 1040-V, 1040-ES, 1041-V, the 94X family, and 2290 vouchers. Software developers must follow these specific guidelines to produce scannable vouchers strictly for lockbox purposes. Also see *Exhibit A*.

- The total depth must be 3.25 inches.
- The scan line must be 0.5 inches from the bottom edge and 1.75 inches from the left edge of the voucher and left justified.
- Software developers' vouchers must be 8.5 inches wide (instead of 8 inches with a cut line). Therefore, no vertical cut line is required.
- Scan line positioning must be exact.
- Do not use the over-the-counter format voucher and add the scan line to it.
- All scanned data must be in 12-point OCR A font.
- The 4-digit NACTP ID code or IRS source code should be placed under the payment indicator arrow.
- Windowed envelopes must not display the scan line in order to avoid disclosure and privacy issues.

Note. All software developers must ensure that their software uses OCR A font so taxpayers will be able to print the vouchers in the correct font.

2.3.8 Specific Line Positions

Follow these line specifications for entering taxpayer data in the lockbox vouchers.

	Start Row	Start Column	Width	End Column
Line Specifications for Taxpayer Data:				
Taxpayer Name	56	6	36	41
Taxpayer Address, Apt.	57	6	36	41
Taxpayer City, State, ZIP	58	6	36	41
Foreign Country Name	59	6	36	41
Foreign Province/Country	60	6	17	22
Foreign Postal Code	60	26	16	41
Line Specifications for Mail To Data:				
Mail Name	56	43	38	80

	Start Row	Start Column	Width	End Column
Mail Address	57	43	38	80
Mail City, State, ZIP	58	43	38	80
Line Specifications for:				
Scan Line	63	26	n/a	n/a

2.3.9 How To Get Approval

To receive approval, please send in 25 voucher samples yearly for each form type or scenario, by December 13, 2019, for testing to the following address.

Internal Revenue Service
Attn: Doris Bethea, C5-226
5000 Ellin Road
Lanham, MD 20706

For further information, contact Doris Bethea, *Doris.E.Bethea@irs.gov*, at 240-613-5922 (not toll free), or Kathryn Wheelock, *Kathryn.F.Wheelock@irs.gov*, at 816-499-4443 (not toll free).

Section 2.4 – Restrictions on Changes

2.4.1 What You Cannot Do to Forms Suitable for Substitute Tax Forms

You cannot, without prior IRS approval, change any IRS tax form or use your own (nonapproved) versions including graphics, unless specifically permitted by this revenue procedure. See *Sections 2.5.7 to 2.5.11*.

You cannot adjust any of the graphics on Form 1040 or 1040-SR (except in those areas specified in *Part 5* of this revenue procedure) without prior approval from the Program.

You cannot rearrange or redistribute data entry fields, and/or allow data entry fields to flow from one page onto the next (that is, each page of a substitute form must contain the exact number of data entry fields as there are on the official IRS form). The order of information on the substitute form must be identical to the IRS version of the form. Publications for specific substitute forms will state allowances for those respective forms.

Note. The 20-business-day turnaround policy may not apply to extensive changes.

Section 2.5 – Guidelines for Obtaining IRS Approval

2.5.1 Basic Requirements

Preparers who submit substitute privately designed, privately printed, computer-generated, or computer-prepared tax forms must develop these substitutes using the guidelines established in this part. These forms, unless there is an exception outlined by the revenue procedure, must be approved by the IRS before being filed.

2.5.2 Conditional Approval Based on Advance Drafts

The IRS cannot grant final approval of your substitute form until the official form has been published. However, the IRS posts advance draft forms on its website at IRS.gov/DraftForms.

We encourage submission of proposed substitutes of these advance draft forms and will grant conditional approval based solely on these early drafts. These advance drafts are subject to significant change before forms are finalized. If these advance drafts are used as the basis for your substitute forms, you will be responsible for subsequently updating your final forms to agree with the final official version. These revisions need not be resubmitted for further approval.

Note. Approval of forms based on advance drafts will not be granted after the final version of an official form is published.

2.5.3 Submission Procedures

Follow these general guidelines when submitting substitute forms for approval.

- Any alteration of forms must be within the limits acceptable to the IRS. It is possible that, from one filing period to another, a change in law or a change in internal need (processing, audit, compliance, etc.) may change the allowable limits for the alteration of the official form.
 - When approval of any substitute form (other than those exceptions specified in *Part 1, Section 1.2 – IRS Contacts*) is requested, a sample of the proposed substitute form should be emailed for consideration to the Program at the address shown in *Section 1.2.1*.
 - Schedules and forms (for example, Forms 3468, 4136, etc.) that can be used with more than one type of return (for example, 1040, 1040-SR, 1041, 1120, etc.) should be submitted only once for approval, without regard to the number of different tax returns with which they may be associated. Also, all pages of multi-page forms or returns should be submitted in the same package.
-

2.5.4 Approving Offices

Because only the Program is authorized to approve substitute forms, unnecessary delays may occur if forms are sent to the wrong office. You may receive an interim letter about the delay. The Program may then coordinate the response with the originator responsible for revising that particular form. Such coordination may include allowing the originator to officially approve the form. No IRS office is authorized to allow deviations from this revenue procedure.

2.5.5 IRS Review of Software Programs, etc.

The IRS does not review or approve the logic of specific software programs, nor does the IRS confirm the calculations on the forms produced by these programs. The accuracy of the program remains the responsibility of the software package developer, distributor, or user.

The Program is primarily concerned with the pre-filing quality review of the final forms that are expected to be processed by IRS field offices. For this purpose, you should submit forms without including any taxpayer information such as names, addresses, monetary amounts, etc.

If the software used is programmed to produce copies with populated fields, then you must use dummy information. This will allow the Program to review and provide feedback or approval. Vendors should use “0” for all number values and “X” for any information that requires alpha characters.

2.5.6	Proposed substitutes, which are required to be submitted per this revenue procedure, should be sent as much in advance of the filing period as possible. This is to allow adequate time for analysis and response.
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2.5.7	When submitting sample substitutes, you should include an accompanying statement that lists each form number and its changes from the official form (position, arrangement, appearance, line numbers, additions, deletions, etc.). With each of the items, you should include a detailed reason for the change.
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When requesting approval, please include a checksheet. Checksheets expedite the approval process. The checksheet may look like the example in *Exhibit B* displayed in the back of this procedure or may be one of your own design.

Please include your email address on the checksheet.

2.5.8	The Program will email the checksheet or an approval letter to the originator, unless:
Approval/ Nonapproval Notice	<ul style="list-style-type: none">• The requester has asked for a formal letter, or• Significant corrections to the submitted forms are required.

Notice of approval may impose qualifications before using the substitutes. Notices of unapproved forms may specify the changes required for approval and require resubmission of the form(s) in question. When appropriate, you will be contacted by telephone.

2.5.9	Most signature tax returns and many of their schedules and related forms have the tax (liability) year printed in the upper right corner. Approvals for these annual forms are usually good for 1 calendar year (January through December of the year of filing). Quarterly tax forms in the 94X series and Form 720 require approval for any quarter in which the form has been revised.
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Because changes are usually made to an annual form every year, each new filing season generally requires a new submission of a substitute form. Very rarely is updating the preprinted year the only change made to an annual form. However, if no significant content, formatting, or layout changes were made to a tax form, then review and approval received for the prior tax year can be carried over into the current tax year.

2.5.10	Limited changes approved for one tax year may be allowed for the same form in the following tax year. Examples are the use of abbreviated words, revised form spacing, compressed text lines, and shortened captions, etc., which do not change the integrity of lines or text on the official forms.
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If the vendor or filer makes substantial changes to the form, new substitutes must be submitted for approval. If the vendor or filer makes only insubstantial editorial changes to the form, or makes any changes that mirror changes the IRS makes to the form's official version, the new substitute need not be submitted for approval. It is the responsibility of each vendor who has been granted

permission to produce substitute forms to monitor and revise forms to mirror any revisions to official forms made by the IRS. If there are any questions, please contact the Program.

2.5.11 When Approval Is Not Required

If you received approval for a specific change on a form last year, you may make the same change this year if the item is still present on the official form.

- The new substitute form does not have to be submitted to the IRS and approval based on that change is not required.
- However, the new substitute form must conform to the official current year IRS form in other respects: date, Office of Management and Budget (OMB) approval number, attachment sequence number, Paperwork Reduction Act Notice statement, arrangement, item caption, line number, line reference, data sequence, etc.
- The new substitute form must also comply with changes to the guidelines in this revenue procedure. The procedure may have eliminated, added to, or otherwise changed the guideline(s) that affected the change approved in the prior year.
- An approved change is authorized only for the period from a prior tax year substitute form to a current tax year substitute form.

Exception. Forms with temporary, limited, or interim approvals (or with approvals that state a change is not allowed in any other tax year) are subject to review in subsequent years.

2.5.12 Required Copies

Generally, you must send us one copy of each form being submitted for approval. However, if you are producing forms for different computer platforms (for example, Microsoft vs. Apple), different tax preparation software (for example, TurboTax® vs. TaxSlayer®), or different types of printers (for example, inkjet vs. impact), and these forms differ **significantly** in appearance, submit one copy for each type of platform, tax preparation software, or printer.

2.5.13 Requestor's Responsibility

Following receipt of an initial approval for a substitute forms package or a software output program to print substitute forms, it is the responsibility of the originator (designer or distributor) to provide client firms or individuals with forms that meet the IRS's requirements for continuing acceptability. Examples of this responsibility include:

- Using the prescribed print paper, font size, legibility, state tax data deletion, etc.; and
 - Informing all users of substitute forms of the legal requirements of the Paperwork Reduction Act Notice, which is generally found in the instructions for the official IRS forms.
-

2.5.14 Source Code

The Program will assign a unique source code to each firm that submits substitute forms for approval. This source code will be a permanent identifier that must be used on every submission by a particular firm.

The source code consists of three alpha characters and should generally be printed under or to the left of the “Paperwork Reduction Act” statement. Vendors must ensure that the source code is not printed too close to or within the left or bottom 1/2-inch margin to avoid the source code from being cut off during printing.

Section 2.6 – Office of Management and Budget (OMB) Requirements for All Substitute Forms

2.6.1 OMB Requirements for All Substitute Forms

There are legal requirements of the Paperwork Reduction Act of 1995 (the Act). Public Law 104-13 requires the following.

- OMB approves all IRS tax forms that are subject to the Act.
- Each IRS form contains (in the upper right corner) the OMB number, if assigned.
- Each IRS form (or its instructions) states why the IRS needs the information, how it will be used, and whether or not the information is required to be furnished to the IRS.

This information must be provided to every user of official or substitute IRS forms or instructions.

2.6.2 Application of the Paperwork Reduction Act

On forms that have been assigned OMB numbers:

- All substitute forms must contain in the upper right corner the OMB number that is on the official form, and
 - The required format is: OMB No. 1545-XXXX (preferred) or OMB # 1545-XXXX (acceptable).
-

2.6.3 Required Explanation to Users

You must inform the users of your substitute forms of the IRS use and collection requirements stated in the instructions for official IRS forms.

- If you provide your users or customers with the official IRS instructions, each form must retain either the Paperwork Reduction Act Notice (or Disclosure, Privacy Act, and Paperwork Reduction Act Notice), or a reference to it as the IRS does on the official forms (usually in the lower left corner of the forms).
- This notice reads, in part, “We ask for tax return information to carry out the tax laws of the United States....”

Note. If no IRS instructions are provided to users of your forms, the exact text of the Paperwork Reduction Act Notice (or Disclosure, Privacy Act, and Paperwork Reduction Act Notice) must be furnished separately or on the form.

2.6.4
**Finding the
OMB Number
and Paperwork
Reduction Act
Notice**

The OMB number and the Paperwork Reduction Act Notice, or references to it, may be found printed on an official form (or its instructions). The number and the notice are included on the official paper format and in other formats produced by the IRS.

Part 3
Physical Aspects and Requirements

Section 3.1 – General Guidelines for Substitute Forms

3.1.1
General Information

The official form is the standard. Because a substitute form is a variation from the official form, you should know the requirements of the official form for the year of use before you modify it to meet your needs. To obtain the most frequently used tax forms, visit *IRS.gov/OrderForms*.

3.1.2
Design

Each form must follow the design of the official form as to format arrangement, item caption, line numbers, line references, and sequence.

3.1.3
**State Tax
Information
Prohibited**

Generally, state tax information must not appear on the federal tax return, associated form, or schedule that is filed with the IRS. Exceptions occur when amounts are claimed on, or required by, the federal return (for example, state and local income taxes on Schedule A (Form 1040 or 1040-SR)).

3.1.4
**Vertical Alignment
of Amount Fields**

IF a form is to be...	THEN...
manually prepared and the official IRS form still has a separate cents entry field	1. the entry column must have a vertical line or some type of indicator in the amount field to separate dollars from cents. 2. the cents column must be at least 3/10" wide.
computer generated	1. vertically align the amount entry fields where possible. 2. use one of the following amount formats. a) 0,000,000. b) 0,000,000.00.
computer prepared	1. you may remove the vertical line in the amount field that separates dollars from cents. 2. use one of the following amount formats. a) 0,000,000. b) 0,000,000.00.

3.1.5 Attachment Sequence Number

Many individual income tax forms have a required “attachment sequence number” located just below the year designation in the upper right corner of the form. The IRS uses this number to indicate the order in which forms are to be attached to the tax return for processing. Some of the attachment sequence numbers may change from year to year.

The following applies to computer-prepared forms.

- The sequence number may be printed in no less than 12-point boldface type and centered below the form’s year designation.
 - The sequence number may also be placed following the year designation for the tax form and separated with an asterisk.
 - The actual number may be printed without labeling it the “Attachment Sequence Number.”
-

3.1.6 Assembly of Forms

When developing software or forms for use by others, please inform your customers/clients that the order in which the forms are arranged may affect the processing of the package. A return must be arranged in the order indicated below.

IF the form is...	THEN the sequence is...
1040 or 1040-SR	Form 1040 or 1040-SR, and schedules and forms in attachment sequence number order.
any other tax return (Form 1120, 1120-S, 1065, 1041, etc.)	the tax returns, directly associated schedules (Schedule D, etc.), directly associated forms, additional schedules in alphabetical order, and additional forms in numerical order.

Supporting statements should then follow in the same sequence as the forms they support. Additional information required should be attached last.

In this way, the forms are received in the order in which they must be processed. If you do not send returns to the IRS in order, processing may be delayed.

3.1.7 Paid Preparer’s Information and Signature Area

On Forms 1040, 1040-SR, 1120, etc., the “Paid Preparer Use Only” area may not be rearranged or relocated. You may, however, add three extra lines to the paid preparer’s address area, and remove the horizontal rules in that area without prior approval. This applies to other tax forms as well.

3.1.8 Some Common Reasons for Requiring Changes to Substitute Forms

Some reasons that substitute form submissions may require changes include the following.

- Shading areas incorrectly.
- Failing to include a reference to the location of the Paperwork Reduction Act Notice.
- Not including parentheses for losses.
- Not including “Attach Statement” when appropriate.
- Including line references or entry spaces that do not match the official form.

- Printing text that is different from the official form.
 - Altering the jurat (perjury statement).
 - Having an incorrect OMB number.
 - Including the IRS catalog number (Cat. No.) on the form.
 - Failing to include preprinted amounts in entry fields.
 - Missing IRS source code or NACTP software ID.
 - Incorrect dimensions.
-

Section 3.2 – Paper

3.2.1 Paper Content

The paper must be:

- Chemical wood writing paper that is equal to or better than the quality used for the official form,
 - At least 18 pound (17" x 22", 500 sheets), or
 - At least 50 pound offset book (25" x 38", 500 sheets).
-

3.2.2 Paper With Chemical Transfer Properties

There are several kinds of paper prohibited for substitute forms. These are:

1. Carbon-bonded paper, and
2. Chemical transfer paper except when the following specifications are met.
 - a. Each ply within the chemical transfer set of forms must be labeled.
 - b. Only the top ply (ply one and white in color), the one that contains chemical on the back only (coated back), may be filed with the IRS.

Example. A set containing three plies would be constructed as follows: ply one (coated back), “Federal Return, File with IRS”; ply two (coated front and back), “Taxpayer’s copy”; and ply three (coated front), “Preparer’s copy.”

The file designation, “Federal Return, File with IRS” for ply one, must be printed in the bottom right margin (just below the last line of the form) in 12-point boldface type.

It is not mandatory, but recommended, that the file designation “Federal Return, File with IRS” be printed in a contrasting ink for visual emphasis.

3.2.3 Paper and Ink Color

It is preferred that the color and opacity of paper substantially duplicates that of the original form. This means that your substitute must be printed in black ink and may be on white or on the colored paper the IRS form is printed on. Form 1040 or 1040-SR substitute reproductions may be in black ink without the colored shading. The only exception to this rule is Form 1041-ES, which should be printed with a PMS 100 yellow shading in the color screened area. This is necessary to assist us in expeditiously separating this form from the very similar Form 1040-ES.

3.2.4 Page Size

Substitute or reproduced forms and computer-prepared/-generated substitutes may be the same size as the official form or they may be the standard commercial size (8 1/2" x 11"). The thickness of the stock cannot be less than 0.003 inches.

Section 3.3 – Printing

3.3.1 Printing Medium

The private printing of all substitute tax forms must be by conventional printing processes, photo-copying, computer graphics, or similar reproduction processes.

3.3.2 Legibility

All forms must have a high standard of legibility as to printing, reproduction, and fill-in matter. Entries of taxpayer data may be no smaller than 8 points. The IRS reserves the right to reject those with poor legibility. The ink and printing method used must ensure that no part of a form (including text, graphics, data entries, etc.) develops "smears" or similar quality deterioration. This standard must be followed for any subsequent copies or reproductions made from an approved master substitute form, either during preparation or during IRS processing.

3.3.3 Type Font

Many federal tax forms are printed using "Helvetica" as the basic type font. It is preferred that you use this type font when composing substitute forms.

3.3.4 Print Spacing

Substitute forms should be printed using a 6 lines/inch vertical print option. They also should be printed horizontally in 10-pitch pica (that is, 10 print characters per inch) or 12-pitch elite (that is, 12 print positions per inch).

3.3.5 Image Size

The image size of a printed substitute form should be as close as possible to that of the official form. You may omit any text on both computer-prepared and computer-generated forms that is solely instructional.

3.3.6
Title Area Changes

To allow a large top margin for marginal printing and more lines per page, the title line(s) for all substitute forms (not including the form's year designation and sequence number, when present) may be photographically reduced by 40% or reset as one line of type. When reset as one line, the type size may be no smaller than 14-point. You may omit "Department of the Treasury—Internal Revenue Service" and all reference to instructions in the form's title area.

3.3.7
**Remove
Government
Printing Office
Symbol and IRS
Catalog Number**

When privately printing substitute tax forms, the Government Printing Office (GPO) symbol and/or jacket number must be removed. In the same place using the same type size, print the Employer Identification Number (EIN) of the printer or designer or the IRS-assigned source code. (We prefer this last number be printed in the lower left area of the first page of each form.) Also, remove the IRS catalog number (Cat. No.) and the recycle symbol if the substitute is not produced on recycled paper.

3.3.8
**Printing Single Page
Forms**

Substitute single page forms should be reproduced the same as IRS single page forms. Other forms or schedules should not be printed on the back or on blank portions of a single page form. However, printing instructions on the back or on blank portions of a single page form is acceptable.

3.3.9
**Photocopy
Equipment**

The IRS does not undertake to approve or disapprove the specific equipment or process used in reproducing official forms. Photocopies of forms must be entirely legible and satisfy the conditions stated in this and other revenue procedures.

3.3.10
Reproductions

Reproductions of official forms and substitute forms that do not meet the requirements of this revenue procedure may not be filed instead of the official forms. Illegible photocopies are subject to being returned to the filer for resubmission of legible copies.

3.3.11
**Removal of
Instructions**

Generally, you may remove references to instructions. No prior approval is needed. However, in some instances, you may be requested to include references to instructions.

Exception. The words "For Paperwork Reduction Act Notice, see instructions" must be retained, or a similar statement indicating the location of the Notice must be provided on each form.

Section 3.4 – Margins

3.4.1
Margin Size

The format of a reproduced tax form when printed on the page must have margins on all sides at least as large as the margins on the official form. This allows room for IRS employees to make necessary entries on the form during processing.

- A $\frac{1}{2}$ -inch to $\frac{1}{4}$ -inch margin must be maintained across the top, bottom, and both sides of all substitute forms.
 - The marginal, perforated strips containing pin-fed holes must be removed from all forms prior to filing with the IRS.
-

3.4.2 Marginal Printing

Prior approval is not required for the marginal printing allowed when printed on an official form or on a photocopy of an official form.

- With the exception of the actual tax return forms (for example, Forms 1040, 1040-SR, 1120, 940, 941, etc.), you may print in the left vertical margin and in the left half of the bottom margin.
 - Printing is never allowed in the top right margin of the tax return form (for example, Forms 1040, 1040-SR, 1120, 940, 941, etc.). The IRS uses this area to imprint a Document Locator Number for each return. There are no exceptions to this requirement.
-

Section 3.5 – Miscellaneous Information for Substitute Forms

3.5.1 Filing Substitute Forms

To be acceptable for filing, a substitute form must print out in a format that will allow the filer to follow the same instructions that accompany official forms.

The form must be legible, must be on the appropriately sized paper, and must include a jurat (perjury statement) where one appears on the published form.

3.5.2 Caution to Software Publishers

The IRS has received returns produced by software packages with approved output where either the form heading was altered or the lines were spaced irregularly. This produces an illegible or unrecognizable return or a return with the wrong number of pages. We realize that many of these problems are caused by individual printer differences but they may delay input of return data and, in some cases, generate correspondence to the taxpayer. Therefore, in the instructions to the purchasers of your product, both individual and professional, please stress that their returns will be processed more efficiently if they are properly formatted. This includes:

- Having the correct form numbers, six-digit form identifying numbers, and titles at the top of the return; and
 - Submitting the same number of pages as if the form were an official IRS form with the line items on the proper pages.
-

3.5.3 Caution to Producers of Software Packages

If you are producing a software package that generates name and address data onto the tax return, do not, under any circumstances, program either the IRS preprinted check digits or a practitioner-derived name control to appear on any return prepared and filed with the IRS.

**3.5.4
Programming to
Print Forms**

Whenever applicable:

- Use only the following label information format for single filers: JOHN Q. DOE 000 OAK DRIVE HOMETOWN, STATE 00000
- Use only the following information for joint filers: JOHN Q. DOE MARY Q. DOE 000 OAK DRIVE HOMETOWN, STATE 00000
- Use “0” for number values and “X” for alpha characters entered in data entry fields as dummy copy.

**Part 4
Additional Resources**

Section 4.1 – Guidance From Other Revenue Procedures

**4.1.1
General**

The IRS publications listed below provide guidance for substitute tax forms not covered in this revenue procedure. These publications are available on the IRS website. Use the publication number listed below to search for the requested document.

- Pub. 1141, General Rules and Specifications for Substitute Forms W-2 and W-3.
- Pub. 1179, General Rules and Specifications for Substitute Forms 1096, 1098, 1099, 5498, and Certain Other Information Returns.
- Pub. 1223, General Rules and Specifications for Substitute Forms W-2c and W-3c.
- Pub. 4436, General Rules and Specifications for Substitute Form 941, Schedule B (Form 941), Schedule D (Form 941), Schedule R (Form 941), and Form 8974.
- Pub. 5223, General Rules and Specifications for Affordable Care Act Substitute Forms 1095-A, 1094-B, 1095-B, 1094-C, and 1095-C.

Section 4.2 – Electronic Tax Products

**4.2.1
The IRS Website**

Copies of tax forms, their instructions, publications, fillable forms, and prior year forms and publications, may be found on the IRS website at *IRS.gov/FormsPubs*.

Draft forms and instructions may be found at *IRS.gov/DraftForms*.

Other tax-related information may be found at *IRS.gov*.

**4.2.2
System
Requirements and
Ordering Forms and
Instructions**

For system requirements, contact the National Technical Information Service (NTIS) at *NTIS.gov*. Prices are subject to change.

You can order IRS forms and other tax material at *IRS.gov/OrderForms*.

**Part 5
Requirements for Specific Tax Returns**

Section 5.1 – Tax Returns (Forms 1040, 1040-SR, 1120, etc.)

**5.1.1
Acceptable Forms**

Tax return forms (such as Forms 1040, 1040-SR, and 1120) require a signature and establish tax liability. Computer-generated versions are acceptable under the following conditions.

- These substitute forms must be printed on plain white paper.
 - Substitute forms must conform to the physical layout of the corresponding IRS form although the typeface may differ. The text should match the text on the officially published form as closely as possible. Condensed text and abbreviations will be considered on a case-by-case basis.
Caution. All jurats (perjury statements) must be reproduced verbatim. No text can be added, deleted, or changed in meaning.
 - Various computer graphic print media such as laser printing, inkjet printing, etc., may be used to produce the substitute forms.
 - The substitute form must be the same number of pages and contain the same line text as the official form.
 - All substitute forms must be submitted for approval prior to their original use. You do not need approval for a substitute form if its only change is the preprinted year and you had received a prior year approval letter. **Exception.** If the approval letter specifies a one-time exception for your form, the next year's form must be approved.
-

**5.1.2
Prohibited Forms**

The following are prohibited.

- Computer-generated tax forms (for example, Form 1040, 1040-SR, etc.) on lined or color-barred paper.
 - Tax forms that differ from the official IRS forms in a manner that makes them nonstandard or unable to process.
-

**5.1.3
Changes Permitted
to Form 1040**

Certain changes (listed in *Section 5.2*) are permitted to the graphics of the form without prior approval, but these changes apply to only acceptable preprinted forms. Changes not requiring prior approval are good only for the annual filing period, which is the current tax year. Such changes are valid in subsequent years only if the official form does not change.

**5.1.4
Other Changes Not
Listed**

All changes not listed in *Section 5.2* require approval from the IRS before the form can be filed.

Section 5.2 – Changes Permitted to Graphics (Form 1040 or 1040-SR)

**5.2.1
Adjustments**

You may make minor vertical and horizontal spacing adjustments to allow for computer or word processing printing. This includes widening the amount columns or tax entry areas if the adjustments comply with other provisions stated in revenue procedures. No prior approval is needed for these changes.

Schedules 1–3 cannot be combined for filing purposes. For the client copy of the return, the numbered schedules may be printed two to a page (for example, Schedule 3 below Schedule 2, if both are completed as part of the return). If numbered schedules are combined on the client copy, it must include a statement that it is “Not for Filing.”

**5.2.2
Name and Address
Area**

The horizontal rules and instructions within the name and address area may be removed and the entire area left blank. No line or instruction can remain in the area. The heavy-ruled border (when present) that outlines the name, address area, and social security number must not be removed, relocated, expanded, or contracted.

**5.2.3
Required Format**

When the name and address area is left blank, the following format must be used when printing the taxpayer’s name and address.

- 1st name line (35 characters maximum).
 - 2nd name line (35 characters maximum).
 - In-care-of name line (35 characters maximum).
 - City, state (25 characters maximum), one blank character, and ZIP code.
-

**5.2.4
Conventional Name
and Address Data**

When there is no in-care-of name line, the name and address will consist of only three lines (single filer) or four lines (joint filer). Name and address (joint filer) with no in-care-of name line:

JOHN Q. DOE
MARY Q. DOE
000 ANYWHERE ST., APT. 000
ANYTOWN, STATE 00000

Example of in-care-of name line. Name and address (single filer) with in-care-of name line:

JOHN Q. DOE
C/O JOHN R. DOE
0000 SOMEWHERE AVE.
SAMETOWN, STATE 00000

**5.2.5
SSN and Employer
Identification
Number (EIN) Area**

The broken vertical lines separating the format arrangement of the SSN/EIN may be removed. When the vertical lines are removed, the SSN and EIN formats must be 000-00-0000 or 00-000000, respectively.

**5.2.6
Entering Cents**

- You may remove the vertical rule that separates the dollars from the cents if it is still included on the official IRS form.
 - All entries in the amount column should have a decimal point following the whole dollar amounts whether or not the vertical line that separates the dollars from the cents is present.
 - You may omit printing the cents, but all amounts entered on the form must follow a consistent format. You are strongly urged to round off the figures to whole dollar amounts, following the official form instructions.
 - When several amounts are added together, the total should be rounded off after addition (that is, individual amounts should not be rounded off for computation purposes).
 - When printing money amounts, you must use one of the following formats: (a) 0,000,000; (b) 0,000,000.00.
 - When there is no entry for a line, leave the line blank.
-

**5.2.7
Changes to Lines**

No prior approval is needed for the following changes (for use with computer-prepared forms only). Specific line numbers in the following headings may have changed due to tax law changes.

**5.2.8
Dependents on
Form 1040**

The vertical lines separating columns (1) through (4) may be removed. The captions may be shortened to allow a one-line caption for each column.

**5.2.9
Other Lines**

Any other line with text that takes up two or more vertical lines may be compressed to one line by using contractions, etc., and by removing instructional references.

**5.2.10
Form 1040 – Tax**

You may change the line caption to read “Tax” and computer print the words “Total includes tax from” and either “Form(s) 8814” or “Form 4972” or “962 election.” If both forms are used, print both form numbers. This specific line number may have changed.

**5.2.11
Color Screening**

It is not necessary to duplicate the color screening used on the official form. A substitute Form 1040 or 1040-SR may be printed in black and white only with no color screening.

**5.2.12
Other Changes
Prohibited**

No other changes to the Form 1040 or 1040-SR graphics are permitted without prior approval except for the removal of instructions and references to instructions.

**Part 6
Format and Content of Substitute Returns**

Section 6.1 – Acceptable Formats for Substitute Forms and Schedules

**6.1.1
Exhibits and Use of
Acceptable Formats**

Exhibit A is an acceptable format for Form 1040-ES.

- If your computer-generated Form 1040-ES appears exactly like *Exhibit A*, no prior authorization is needed.
 - You may computer-generate forms not shown here, but you must design them by following the manner and style discussed in *Part 3*.
 - Take care to observe other requirements and conditions in this revenue procedure. The IRS encourages the submission of all proposed forms covered by this revenue procedure.
-

**6.1.2
Instructions**

The format of each substitute form or schedule must follow the format of the official form or schedule as to item captions, line references, line numbers, sequence, form arrangement and format, etc. Basically, try to make the form look like the official one, with readability and consistency being primary factors. You may use periods and/or other similar special characters to separate the various parts and sections of the form. Do not use alpha or numeric characters for these purposes. All line numbers and items must be printed even though an amount is not entered on the line.

**6.1.3
Line Numbers**

When a line on an official form is designated by a number or a letter, that designation (reference code) must be used on a substitute form. The reference code must be printed to the left of the text of each line and immediately preceding the data entry field, even if no reference code precedes the data entry field on the official form. If an entry field contains multiple lines and shows the line references once on the left and right side of the form, use the same number of line references on the substitute form.

In addition, the reference code that is immediately before the data field must either be followed by a period or enclosed in parentheses. There must also be at least two blank spaces between the period or the right parenthesis and the first digit of the data field. (See *Section 6.1.4*.)

6.1.4 Decimal Points

A decimal point (a period) should be used for each money amount regardless of whether the amount is reported in dollars and cents or in whole dollars, or whether or not the vertical line that separates the dollars from the cents is present. The decimal points must be vertically aligned when possible.

Example:

5 State and local taxes

a State and local income taxes.....	5a.	000.00
b State and local real estate taxes.....	5b.	
c State and local personal property taxes....	5c.	000.00

or

a State and local income taxes.....	(5a)	000.00
b State and local real estate taxes.....	(5b)	
c State and local personal property taxes....	(5c)	000.00

6.1.5 Multi-Page Forms

When submitting a multi-page form, send all its pages in the same package. If you will not be producing certain pages, please note that in your cover letter.

Section 6.2 – Additional Instructions for All Forms

6.2.1 Use of Your Own Internal Control Numbers and Identifying Symbols

You may show the computer-prepared internal control numbers and identifying symbols on the substitute if using such numbers or symbols is acceptable to the taxpayer and the taxpayer's representative. Such information must not be printed in the top 1/2-inch clear area of any form or schedule requiring a signature.

Except for the actual tax return form (Forms 1040, 1040-SR, 1120, 940, 941, etc.), you may print in the left vertical and bottom left margins. The bottom left margin you may use extends 3 1/2 inches from the left edge of the form. You may print internal control numbers in place of the removed IRS catalog number.

6.2.2 Required Software ID Number (Source Code) on Computer- Prepared Substitutes

In the February 2009 Government Accountability Office (GAO) report, "Many Taxpayers Rely on Tax Software and IRS Needs to Assess Associated Risks" (GAO-09-297), the GAO recommended that the IRS require a software identification number on all individual returns to specifically identify the software package used to prepare each tax return. The IRS already has this capability for all e-filed returns. In addition, many tax preparation software firms already print an IRS-issued 3-letter Source Code on paper returns that are generated by their individual tax software. This Source Code was assigned when the firms were seeking substitute forms approval under this current publication.

In order to respond properly to this GAO recommendation, the IRS will require all tax preparation software firms to include the 3-letter Source Code on all paper tax returns created by their individual tax preparation software. The many firms that currently have and display their Source Code on paper returns generated from their software should continue to do so, and no change is necessary.

We have reviewed all software companies that passed Assurance Testing System (ATS) testing last filing season and have determined that some firms do not currently have a Source Code. To save you the burden of contacting us and for your convenience, we have assigned Source Codes to those firms.

You should program your Source Code to be placed in the bottom left-hand corner of page one of each paper form that will be generated by your individual tax return package. You do not need to apply for a new Source Code annually.

If you already use a 3-letter Source Code and we have issued you one in error, you are unsure if you were ever issued one, or have other questions or concerns, you may contact Tax Forms and Publications Special Services Section at substituteforms@irs.gov.

**6.2.3
Descriptions for
Captions, Lines, etc.**

Descriptions for captions, lines, etc., appearing on the substitute forms may be limited to one print line by using abbreviations and contractions, and by omitting articles, prepositions, etc. However, sufficient keywords must be retained to permit ready identification of the caption, line, or item.

**6.2.4
Determining Final
Totals**

Explanatory detail and/or intermediate calculations for determining final line totals may be included on the substitute. We prefer that such calculations be submitted in the form of a supporting statement. If intermediate calculations are included on the substitute, the line on which they appear may not be numbered or lettered. Intermediate calculations may not be printed in the right column.

This column is reserved only for official numbered and lettered lines that correspond to the ones on the official form. Generally, you may choose the format for intermediate calculations or subtotals on supporting statements to be submitted.

**6.2.5
Instructional Text
on the Official Form**

Text on the official form, which is solely instructional (for example, "See instructions," etc.), may generally be omitted from the substitute form.

**6.2.6
Intermingling Is
Prohibited**

Showing more than one form or schedule on the same printout page is prohibited. Both sides of the paper may be used for multi-page forms, but it is unacceptable to intermingle forms.

For instance, Schedule E can be printed on both sides of the paper because the official form is multi-page, with page 2 continued on the back. However, do not print Schedule E on the front page and Schedule SE on the back, or Schedule A on the front and Form 8615 on the back, etc. Both pages of a substitute form must match the official form. The back page may be left blank if the back page of the official form contains only the instructions.

**6.2.7
Identifying
Substitutes**

Identify all computer-prepared substitutes clearly. Print the form designation 1/2 inch from the top margin and 1½ inches from the left margin. Print the title centered on the first line of print. Print the tax year and, where applicable, the sequence number on the same line 1/2 inch to 1 inch from the right margin.

Include the taxpayer's name and SSN on all forms and attachments. Also, print the OMB number as reflected on the official form.

**6.2.8
Negative Amounts**

Negative (or loss) amount entries should be enclosed in brackets or parentheses or include a minus sign. This assists in accurate computation and input of form data. The IRS preprints parentheses in negative data fields on many official forms. These parentheses should be retained or inserted on printouts of affected substitute forms.

**Part 7
Miscellaneous Forms and Programs**

Section 7.1 – Specifications for Substitute Schedules K-1

**7.1.1
Requirements for
Schedules K-1 That
Accompany Forms
1041, 1065, and
1120-S**

Because of significant changes to improve processing, prior approval is now required for substitute Schedules K-1 that accompany Form 1041 (for estates and trusts), Form 1065 (for partnerships), or Form 1120-S (for S corporations). Substitute Schedules K-1 should be as close as possible to exact replicas of copies of the official IRS schedules and follow the same process for submitting other substitute forms and schedules. Before releasing their substitute forms, software vendors are responsible for making any subsequent changes that have been made to the final official IRS forms after the draft forms have been posted.

Submit substitute Schedule K-1 forms, in PDF format, to *scripts@irs.gov* for scannability acceptance. Schedule K-1 forms that require testing do not need to be mailed to the Program. You must include information on the substitute that can be tested. This information should be dummy information. Use an "X" for alpha characters and "0" for numbers. The IRS will review and provide feedback of any changes needed so that your forms can be recognized correctly.

Include the 6-digit form ID code in the upper right of Schedules K-1 of Forms 1041, 1065, and 1120-S. Please allow at least 1/4 inch of white space around the 6-digit code.

- 661117 for Form 1041.
- 651119 for Form 1065.
- 671119 for Form 1120-S.

Schedules K-1 that accompany Forms 1041, 1065, or 1120-S must meet all specifications. The specifications include, but are not limited to, the following requirements.

- You will no longer be able to produce Schedules K-1 that contain only those lines or boxes that taxpayers are required to use. All lines must be included.

- The words “*See attached statement for additional information.” must be preprinted in the lower right-hand side on Schedules K-1 of Forms 1041, 1065, and 1120-S.
- All Schedules K-1 that are filed with the IRS should be printed on standard 8.5” x 11” paper (the international standard (A4) of 8.27” x 11.69” may be substituted).
- 10-point Helvetica Light Standard is preferred for all entries that are typed or made using a computer.
- Submissions should include IRS source code or NACTP vendor ID code printed on the lower left corner of the form or in place of the IRS catalog number.
- Each recipient’s information must be on a separate sheet of paper. Therefore, you must separate all continuously printed substitutes, by recipient, before filing with the IRS.
- No carbon copies or pressure-sensitive copies will be accepted.
- The Schedule K-1 must contain the name, address, and SSN or EIN of both the entity (estate, trust, partnership, or S corporation) and the recipient (beneficiary, partner, or shareholder).
- The Schedule K-1 must contain the tax year, the OMB number, the schedule number (K-1), the related form number (1041, 1065, or 1120-S), and the official schedule name in substantially the same position and format as shown on the official IRS schedule.
- The Schedule K-1 must contain all the line items as shown on the official form, except for the instructions, if any are printed on the back of the official Schedule K-1.
- The line items or boxes must be in the same order and arrangement as those on the official form.
- The amount of each recipient’s share of each item must be shown. A partial percent should be reflected as a decimal (for example, 50 1/2% should be 50.5%). Furnishing a total amount of each item and a percentage (or decimal equivalent) to be applied to such total amount by the recipient does not satisfy the law and the specifications of this revenue procedure.
- State or local tax-related information may not be included on the Schedules K-1 filed with the IRS.
- The entity may have to pay a penalty if substitute Schedules K-1 are filed that do not conform to specifications.
- Additionally, the IRS may consider the Schedules K-1 that do not conform to specifications as not being able to be processed and may return Forms 1041, 1065, or 1120-S to the filer to be filed correctly.

Schedules K-1 that are 2-D bar-coded will continue to require prior approval from the IRS (see *Sections 7.1.3 through 7.1.5*).

7.1.2 Special Requirements for Recipient Copies of Schedules K-1

Standardization for reporting information is required for recipient copies of substitute Schedules K-1 of Forms 1041, 1065, and 1120-S. Uniform visual standards are provided to increase compliance by allowing recipients and practitioners to more easily recognize a substitute Schedule K-1. The entity must furnish to each recipient a copy of Schedule K-1 that meets the following requirements.

- Include the 6-digit form ID code in the upper right of Schedules K-1 of Forms 1041, 1065, and 1120-S. Please allow white space around the 6-digit code.
 - 661117 for Form 1041.
 - 651119 for Form 1065.
 - 671119 for Form 1120-S.
- You will no longer be able to produce Schedules K-1 that contain only those lines or boxes that taxpayers are required to use. All lines must be included.
- The words “*See attached statement for additional information.” must be preprinted in the lower right-hand side on Schedules K-1 of Forms 1041, 1065, and 1120-S.
- The Schedule K-1 must contain the name, address, and SSN or EIN of both the entity and recipient.
- The Schedule K-1 must contain the tax year, the OMB number, the schedule number (K-1), the related form number (1041, 1065, or 1120-S), and the official schedule name in substantially the same position and format as shown on the official IRS schedule.
- All applicable amounts and information required to be reported must be titled and numbered in the same manner as shown on the official IRS schedule. The line items or boxes must be in the same order and arrangement and must be numbered like those on the official IRS schedule.
- The Schedule K-1 must contain all items required for use by the recipient. The instructions for the schedule must identify the line or box number and code, if any, for each item as shown in the official IRS schedule.
- The amount of each recipient’s share of each item must be shown. A partial percent should be reflected as a decimal (for example, 50 1/2% should be 50.5%). Furnishing a total amount of each line item and a percentage (or decimal equivalent) to be applied to such total amount by the recipient does not satisfy the law and the specifications of this revenue procedure.
- Instructions to the recipient that are substantially similar to those on or accompanying the official IRS schedule must be provided to aid in the proper reporting of the items on the recipient’s income tax return. Where items are not reported to a recipient because they do not apply, the related instructions may be omitted.
- The quality of the ink or other material used to generate recipients’ schedules must produce clearly legible documents. In general, black chemical transfer inks are preferred.
- In order to assure uniformity of substitute Schedules K-1, the paper size should be standard 8.5” x 11” (the international standard (A4) of 8.27” x 11.69” may be substituted).
- The paper weight, paper color, font type, font size, font color, and page layout must be such that the average recipient can easily decipher the information on each page. The preferred font is “Helvetica” and a minimal of 10-point font.
- State or local tax-related information may be included on recipient copies of substitute Schedules K-1. All non-tax-related information should be separated from the tax information on the substitute schedule to avoid confusion for the recipient.
- The legend “Important Tax Return Document Enclosed” must appear in a bold and conspicuous manner on the outside of the envelope that contains the substitute recipient copy of Schedule K-1.

-
- The entity may have to pay a penalty if a substitute Schedule K-1 furnished to any recipient does not conform to the specifications of this revenue procedure and results in impeding processing.
-

7.1.3 Requirements for Schedules K-1 With Two- Dimensional (2-D) Bar Codes

Electronic filing is now and will continue to be the preferred method of filing; however, 2-D bar code is the best alternative method for paper processing.

In an effort to improve efficiency and increase data accuracy, the IRS partnered with the tax software development community on a two-dimensional bar code project in 2003. Certain tax software packages have been modified to generate 2-D bar codes on Schedules K-1. As a result, when Schedules K-1 are printed using these programs, a bar code will print on the page.

Rather than manually transcribe information from the Schedule K-1, the IRS will scan the bar code and electronically upload the information from the Schedule K-1. The results will be more efficient operation within the IRS and fewer transcription errors for your clients.

Note. If software vendors do not want to produce bar-coded Schedules K-1, they may produce the official IRS Schedules K-1 but cannot use the expedited process for approving bar-coded Schedules K-1 and their parent returns as outlined in *Section 7.1.6*.

In addition to the requirements in *Sections 7.1.1 and 7.1.2*, the bar-coded Schedules K-1 must meet the following specifications.

- The bar code should print in the space labeled “For IRS Use Only” on each Schedule K-1. The entire bar code must print within the “For IRS Use Only” box surrounded by a white space of at least $\frac{1}{4}$ inch.
 - Bar codes must print in PDF 417 format.
 - The bar codes must always be in the specified format with every field represented by at least a field delimiter (carriage return). Leaving out a field in a bar code will cause every subsequent field to be misread.
 - Be sure to include the 6-digit form ID code in the upper right of Schedules K-1 of Forms 1041, 1065, and 1120-S. Please allow white space around the 6-digit code.
 - 661117 for Form 1041.
 - 651119 for Form 1065.
 - 671119 for Form 1120-S.
-

7.1.4 2-D Bar Code Specifications for Schedules K-1

Follow these general specifications for preparing all 2-D bar-coded Schedules K-1.

- Numeric fields.
 - Do not include leading zeros (except Taxpayer Identification Numbers, ZIP codes, and percentages).
 - If negative value, the minus sign “–” must be present immediately to the left of the number and part of the 12 position field.

- Do not use non-numeric characters except that the literal “STMT” can be put in money fields.
 - All money fields should be rounded to the nearest whole dollar amount—if a money amount ends in 00 to 49 cents, drop the cents; if it ends in 50 to 99 cents, truncate the cents and increment the dollar amount by one. Use the same rounding technique for the bar-coded and the printed Schedules K-1.
 - All numeric-only fields are right justified (except Taxpayer Identification Numbers and Zip codes).
 - All field lengths are expressed as maximum lengths. If the value in the field has fewer positions or the software program does not support that many positions, put in the bar code only those positions actually used.
 - Alpha fields.
 - Do not include leading blanks (left justified).
 - Do not include trailing blanks.
 - Use uppercase alpha characters only.
 - Variable fields.
 - Do not include leading blanks (left justified).
 - Do not include trailing blanks.
 - Use uppercase alpha characters, numerics, and special characters as defined in each field.
 - Delimit each field with a carriage return.
 - Express percentages as 6-digit numbers without the percent sign. Left justify with leading zero(s) (for percentages less than 100%) and no decimal point (decimal point is assumed between 3rd and 4th positions). Examples: 25.32% expressed as “025320”; 105% expressed as “105000”; 8.275% expressed as “008275”; 10.24674% expressed as “010247.”
 - It is vital that the print routine reinitialize the bar code prior to printing each succeeding Schedule K-1. Failure to do this will result in each Schedule K-1 for a parent return having the same bar code as the document before it.
-

7.1.5 Approval Process for Bar-Coded Schedules K-1

Prior to releasing commercially available tax software that creates bar-coded Schedules K-1, the printed schedule and the bar code must both be tested. If your company is creating bar-coded Schedules K-1, you must receive certification for both the printed Schedule K-1, as well as the bar code before offering your product for sale. Bar-code testing must be done using the final official IRS Schedule K-1. Bar-code approval requests must be resubmitted for any subsequent changes to the official IRS form that would affect the bar code. Below are instructions and a sequence of events that will comprise the testing process.

- The IRS has released the final Schedule K-1 bar-code specifications by publishing them on the IRS.gov website (see *IRS.gov/E-file-Providers/K-1-Bar-Code-Certification-Process*).
- The IRS will publish a set of test documents that will be used to test the ability of tax preparation software to create bar codes in the correct format.

- Software developers will submit two identical copies of the test documents—one to the IRS and one to a contracted testing vendor.
 - The IRS will use one set to ensure the printed schedules comply with standard substitute forms specifications.
 - If the printed forms fail to meet the substitute form criteria, the IRS will inform the software developer of the reason for noncompliance.
 - The software developer must resubmit the Schedule(s) K-1 until they pass the substitute forms criteria.
 - The testing vendor will review the bar codes to ensure they meet the published bar-code specifications.
 - If the bar code(s) does not meet published specifications, the testing vendor will contact the software developer directly informing them of the reason for noncompliance.
 - Software developers must submit new bar-coded schedules until they pass the bar-code test.
 - When the bar code passes, the testing vendor will inform the IRS that the developer has passed the bar-code test and the IRS will issue an overall approval for both the substitute form and the bar code.
 - After receiving this consolidated response, the software vendor is free to release software for tax preparation as long as any subsequent revisions to the schedules do not change the fields.
 - Find the mailing address for the testing vendor below. Separate and simultaneous mailings to the IRS and the vendor will reduce testing time.
-

7.1.6 Procedures for Reducing Testing Time

In order to help provide incentives to the software development community to participate in the Schedule K-1 2-D project, the IRS has committed to expediting the testing of bar-coded Schedules K-1 and their associated parent returns. To receive this expedited service, follow the instructions below.

- Mail the parent returns (Forms 1065, 1120-S, 1041) and associated bar-coded Schedule(s) K-1 to the appropriate address below in a separate package from all other approval requests.

Internal Revenue Service
Attn: Bar-Coded K-1
SE:W:CAR:MP:T:M:S, IR-6526
1111 Constitution Ave. NW
Washington, DC 20224

- Mail one copy of the parent form(s) and Schedule(s) K-1 to the IRS and another copy to the testing vendor at the address below.

Leidos-IRS Paper and Remittance
Processing Support (PRPS II)
Attn: Dana Hawkins
4701 Forbes Blvd.
Lanham, MD 20706

- Include multiple email and phone contact points in the packages.
 - While the IRS can expedite bar-coded Schedules K-1 and their associated parent returns, it cannot expedite the approval of nonassociated tax returns.
 - Vendors are encouraged to visit *NACTP.org* for compliance guidelines in regards to mil size and error-correction level.
 - Submissions should include IRS source code or NACTP vendor ID code printed on the lower left corner of the form or in place of the IRS catalog number.
 - If a change is made to the bar code after approval, be sure to increment the version number.
-

Section 7.2 – Guidelines for Substitute Forms 8655

7.2.1 Increased Standardization for Forms 8655

Increased standardization for reporting information on substitute Forms 8655 is now required to aid in processing and for compliance purposes. Please follow the guidelines in *Section 7.2.2*.

7.2.2 Requirements for Substitute Forms 8655

Please follow these specific requirements when producing substitute Forms 8655.

- The first line of the title must be “Reporting Agent Authorization.”
- If you want to include a reference to “State Limited Power of Attorney,” it can be in parentheses under the title. “State” must be the first word within the parentheses.
- You must include “Form 8655” on the form.
- While the line numbers do not have to match the official form, the sequence of the information must be in the same order.
- The size of any variable data must be printed in a font no smaller than 10-point.
- For adequate disclosure checks, the following must be included for each taxpayer.
 - Name.
 - EIN.
 - Address.
- At this time, Form 944 will not be required if Form 941 is checked. Only those forms that the reporting agent company supports need to be listed.
- The jurat (perjury statement) must be identical with the exception of references to line numbers.
- A contact name and number for the reporting agent is not required.
- Any state information included should be contained in a separate section of the substitute form. Preferably, this information will be in the same area as line 19 of the official form.

- All substitute Forms 8655 must be approved by the Program as outlined in the Form 8655 specifications in this current publication.
 - If you have not already been assigned a 3-letter Source Code, you will be given one when your substitute form is submitted for approval. This Source Code should be included in the lower left corner of the form.
 - The 20-business-day assumed approval policy does not apply to Form 8655 approvals.
-

7.2.3 Exception for Form 8655

Because of how Form 8655 is processed and distributed to recipients, vendors are allowed to affix their logo onto the substitute version of the form. **This exception is for Form 8655 only.**

Part 8 Additional Information

Section 8.1 – Forms for Electronically Filed Returns

8.1.1 Electronic Filing Program

Electronic filing is a method by which authorized providers transmit tax return information to an IRS Service Center in the format of the official IRS forms. The IRS accepts both refund and balance due forms that are filed electronically.

8.1.2 Applying To Participate in IRS e-file

Anyone wishing to participate in IRS *e-file* of tax returns must submit an *e-file* application. The application can be completed and submitted electronically on the IRS website at IRS.gov after first registering for e-services on the website.

8.1.3 Obtaining the Taxpayer Signature/ Submission of Required Paper Documents

Taxpayers choosing to electronically prepare and file their return will be required to use the Self-Select PIN method as their signature.

Electronic Return Originators (EROs) can *e-file* individual income tax returns only if the returns are signed electronically using either the Self-Select or Practitioner PIN method.

Taxpayers must use Form 8453, U.S. Individual Income Tax Transmittal for an IRS *e-file* Return, to send supporting documents that are required to be submitted to the IRS.

For specific information about electronic filing, refer to Pub. 1345, Handbook for Authorized IRS *e-file* Providers of Individual Income Tax Returns.

**8.1.4
Guidelines for
Preparing Substitute
Forms in the
Electronic Filing
Program**

A participant in the electronic filing program who wants to develop a substitute form should follow the guidelines throughout this publication and send a sample form for approval to the Program at substituteforms@irs.gov. If you do not prepare substitute Form 8453 using a font in which all IRS wording fits on a single page, the form will not be accepted.

Note. Use of unapproved forms could result in suspension of the participant from the electronic filing program.

Section 8.2 – Effect on Other Documents

**8.2.1
Effect on Other
Documents**

This revenue procedure supersedes Revenue Procedure 2018-51, 2018-44 I.R.B. 721.

Section 8.3 – Exhibits

Exhibit A — Form 1040-ES Voucher 2019

Exhibit B — Substitute Form Checksheet

Software Developers Voucher

Exhibit A

Form 1040-ES Voucher

Form 1040-ES (OCR)	2019	Estimated Tax	Payment Voucher 1	Calendar year— Due April 15, 2019
Department of the Treasury Internal Revenue Service	OMB No. 1545-0074			
Make your check or money order payable to "United States Treasury." Enter your SSN and "2019 Form 1040-ES" on your payment. If your name, address, or SSN is incorrect, see instructions.				
Amount of estimated tax you are paying by check or money order.			Dollars 0,000	Cents
For Privacy Act and Paperwork Reduction Act Notice, see instructions.				

John Q. Doe
000 Someplace Somewhere Blvd.
City, St 00000

PO Box 00000
City, St 00000 - 0000

000000000 XX DOE 00 0 201912 000

IRS Checksheet

Exhibit B

Substitute Forms Checksheet

Checksheet of IRS Substitute Forms 20 :
Submitted on
Company:
Contact:
Phone:
Fax:
Source Code:

Authorized Name: _____
Title: _____
Reviewer's Name: _____
Telephone: _____
Date: _____

Part IV.

Notice of Proposed Rulemaking

Additional First Year Depreciation Deduction

REG-106808-19

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking; partial withdrawal of a notice of proposed rulemaking.

SUMMARY: This document contains proposed regulations that provide guidance regarding the additional first year depreciation deduction under section 168(k) of the Internal Revenue Code (Code). These proposed regulations reflect and clarify the increase of the benefit and expansion of the universe of qualifying property, particularly to certain classes of used property, made by the Tax Cuts and Jobs Act. These proposed regulations generally affect taxpayers who deduct depreciation for qualified property acquired and placed in service after September 27, 2017. This document also provides notice of a public hearing on these proposed regulations. Finally, this document withdraws a portion of the proposed regulations published on August 8, 2018.

DATES: Written or electronic comments must be received by November 25, 2019. Outlines of topics to be discussed at the public hearing scheduled for Wednesday, November 13, 2019, at 10 a.m. must be received by October 23, 2019. If no outlines of topics are received by October 23, 2019, the public hearing will be cancelled.

ADDRESSES: Submit electronic submissions via the Federal eRulemaking Portal at <https://www.regulations.gov> (indicate IRS and REG-106808-19) by following the online instructions for submitting comments. Once submitted to the Federal eRulemaking Portal, comments cannot be edited or withdrawn. The Department of the Treasury (Treasury Department) and

the IRS will publish for public availability any comment received to its public docket, whether submitted electronically or in hard copy. Send hard copy submissions to: CC:PA:LPD:PR (REG-106808-19), Room 5203, Internal Revenue Service, P.O. Box 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand-delivered Monday through Friday between the hours of 8 a.m. and 4 p.m. to CC:PA:LPD:PR (REG-106808-19), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW, Washington, DC 20224.

FOR FURTHER INFORMATION CONTACT: Concerning the proposed regulations, Elizabeth R. Binder or Kathleen Reed, (202) 317-7005; concerning submissions of comments and outlines of topics, the hearing, or to be placed on the building access list to attend the hearing, Regina L. Johnson, (202) 317-6901 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Background

This document contains proposed amendments to the Income Tax Regulations (26 CFR part 1) under section 168(k) of the Code. Section 168(k) was added to the Code by section 101 of the Job Creation and Worker Assistance Act of 2002, Public Law 107-147 (116 Stat. 21). Section 168(k) allows an additional first year depreciation deduction in the placed-in-service year of qualified property. Subsequent amendments to section 168(k) increased the percentage of the additional first year depreciation deduction from 30 percent to 50 percent (to 100 percent for property acquired and placed in service after September 8, 2010, and generally before January 1, 2012), extended the placed-in-service date generally through December 31, 2019, and made other changes.

On December 22, 2017, section 168(k) and related provisions were amended by sections 12001(b)(13), 13201, and 13204 of the Tax Cuts and Jobs Act, Public Law 115-97 (131 Stat. 2054) (the "Act") to

provide further changes to the additional first year depreciation deduction. Unless otherwise indicated, all references to section 168(k) hereinafter are references to section 168(k) as amended by the Act.

The Treasury Department and the IRS published proposed regulations interpreting section 168(k) on August 8, 2018 (the August Proposed Regulations) (83 FR 39292). This notice of proposed rulemaking withdraws §1.168(k)-2(b)(3)(iii)(B)(3)(i) through (iii) and *Examples 19* through 22 in §1.168(k)-2(b)(3)(vi) of the August Proposed Regulations, and proposes in their place §1.168(k)-2(b)(3)(v)(A) through (E) and *Examples 26* through 30 in §1.168(k)-2(b)(3)(vii)(Z) through (DD), respectively. This notice of proposed rulemaking also withdraws §1.168(k)-2(b)(3)(iii)(C) and *Example 18* in §1.168(k)-2(b)(3)(vi) of the August Proposed Regulations, and proposes in their place §1.168(k)-2(b)(3)(iii)(C) and *Examples 31* through 34 in §1.168(k)-2(b)(3)(vii)(EE) through (HH), respectively. The August Proposed Regulations, with modifications in response to comments and testimony received, were adopted as final regulations, issued concurrently with these proposed regulations and published elsewhere in this issue of the **Federal Register** (the Final Regulations).

Explanation of Provisions

These proposed regulations propose amendments to the Final Regulations to provide taxpayers with guidance that is not addressed in the Final Regulations regarding the application of section 168(k). Specifically, these proposed regulations contain amendments to §1.168(k)-2(b)(2), (3), and (5) of the Final Regulations, each of which provides rules relevant to the definition of qualified property for purposes of the additional first year depreciation deduction under section 168(k). These proposed regulations also amend §1.168(k)-2(b)(3)(v) by adding special rules for consolidated groups. Additionally, these proposed regulations amend §1.168(k)-2(c) by adding rules regarding components acquired or self-constructed after September 27, 2017, for larger

self-constructed property for which manufacture, construction, or production began before September 28, 2017. Further, these proposed regulations amend §1.168(k)-2(g)(11) by adding rules regarding the application of the mid-quarter convention, as determined under section 168(d). These additional proposed rules respond to comments received on the August Proposed Regulations as well as address certain issues identified after additional study. This Explanation of Provisions section describes each of the proposed rules contained in this document.

1. Property Excluded from the Additional First Year Depreciation Deduction by Section 168(k)(9)

Section 1.168(k)-2(b)(2)(ii)(F) of the Final Regulations provides that qualified property does not include any property that is primarily used in a trade or business described in section 163(j)(7)(A)(iv). Section 1.168(k)-2(b)(2)(ii)(G) of the Final Regulations provides that qualified property does not include any property used in a trade or business that has had floor plan financing indebtedness, as defined in section 163(j)(9), if the floor plan financing interest, as defined in section 163(j)(9), related to such indebtedness is taken into account under section 163(j)(1)(C) for the taxable year. Sections 1.168(k)-2(b)(2)(ii)(F) and (G) of the Final Regulations apply to property placed in service by the taxpayer in a taxable year beginning after December 31, 2017.

A. Lessor Leasing Property to a Trade or Business Described in Section 168(k)(9)

Several commenters to the August Proposed Regulations requested guidance on whether a taxpayer that leases property to a trade or business described in section 168(k)(9) is eligible to claim the additional first year depreciation for the property, and they recommend allowing the additional first year depreciation deduction (assuming all other requirements are met). The Treasury Department and the IRS agree with the commenters' recommendation, provided the lessor is not described in section 168(k)(9)(A) or (B). Accordingly, these proposed regulations amend §1.168(k)-2(b)(2)(ii)(F) and (G)

to provide that such exclusion from the additional first year depreciation deduction does not apply to lessors of property to a trade or business described in section 168(k)(9) so long as the lessor is not described in such Code section.

B. Property Described in Section 168(k)(9)(A)

The Treasury Department and the IRS are aware that taxpayers and practitioners have questioned how to determine whether property is primarily used in a trade or business described in section 168(k)(9)(A). For depreciation purposes, §1.167(a)-11(b)(4)(iii)(b) and (e)(3)(iii) classify property according to its primary use. The Treasury Department and the IRS believe that the same standard should apply for purposes of section 168(k)(9)(A). Accordingly, these proposed regulations amend §1.168(k)-2(b)(2)(ii)(F) to provide that for purposes of section 168(k)(9)(A) and §1.168(k)-2(b)(2)(ii)(F), the term *primarily used* has the same meaning as that term is used in §1.167(a)-11(b)(4)(iii)(b) and (e)(3)(iii) for classifying property.

C. Property Described in Section 168(k)(9)(B)

A commenter to the August Proposed Regulations requested guidance on when floor plan financing is "taken into account" for purposes of section 168(k)(9)(B). The commenter believed that section 168(k)(9)(B) does not apply when a taxpayer does not deduct interest in excess of the sum of the amounts calculated under section 163(j)(1)(A) and (B). The Treasury Department and the IRS do not believe that section 163(j) is optional. However, the Treasury Department and the IRS agree that, for purposes of section 168(k)(9)(B), floor plan financing interest is not taken into account by a trade or business that has had floor plan financing indebtedness if the sum of the amounts calculated under section 163(j)(1)(A) and (B) for the trade or business for the taxable year equals or exceeds the business interest, as defined in section 163(j)(5) (including carryforwards of disallowed business interest under section 163(j)(2)), which includes floor plan financing interest of the trade or business, for the taxable year.

Accordingly, these proposed regulations amend §1.168(k)-2(b)(2)(ii)(G) to provide that solely for purposes of section 168(k)(9)(B) and §1.168(k)-2(b)(2)(ii)(G), floor plan financing interest is not taken into account for the taxable year by a trade or business that has had floor plan financing indebtedness if the sum of the amounts calculated under section 163(j)(1)(A) and (B) for the trade or business for the taxable year equals or exceeds the business interest, as defined in section 163(j)(5), for the taxable year.

If floor plan financing interest is taken into account for a taxable year by a trade or business that has had floor plan financing indebtedness, the Treasury Department and the IRS are aware that taxpayers and practitioners have questioned whether the additional first year depreciation deduction is not allowed for property placed in service by that trade or business in any subsequent taxable year. In such a case, the additional first year depreciation deduction for subsequent taxable years would not be allowed, even if the amount of the floor plan financing interest taken into account for the current taxable year is de minimis. For this reason, the Treasury Department and the IRS have decided that, for purposes of section 168(k)(9)(B), the determination of whether a trade or business that has had floor plan financing indebtedness has taken into account floor plan financing interest is made annually. Accordingly, these proposed regulations amend §1.168(k)-2(b)(2)(ii)(G) to provide that if the trade or business has taken floor plan financing interest into account pursuant to §1.168(k)-2(b)(2)(ii)(G) for a taxable year, §1.168(k)-2(b)(2)(ii)(G) applies to any property placed in service by that trade or business in that taxable year.

2. Used Property

A. Depreciable Interest

As a result of comments received on the August Proposed Regulations regarding sale-leaseback transactions, the Treasury Department and the IRS have determined that it is appropriate to provide an exception to the depreciable interest rule in the Final Regulations when the taxpayer disposes of property within a short period of time after the taxpayer placed such

property in service. Accordingly, these proposed regulations amend §1.168(k)-2 by adding paragraph (b)(3)(iii)(B)(4) to provide that if (a) a taxpayer acquires and places in service property, (b) the taxpayer or a predecessor did not previously have a depreciable interest in the property, (c) the taxpayer disposes of the property to an unrelated party within 90 calendar days after the date the property was originally placed in service by the taxpayer (without taking into account the applicable convention), and (d) the taxpayer reacquires and again places in service the property, the taxpayer's depreciable interest in the property during that 90-day period is not taken into account for determining whether the property was used by the taxpayer or a predecessor at any time prior to its reacquisition by the taxpayer. The 90-day period is consistent with the period of time specified in section 168(k)(2)(E)(ii). To prevent the churning of assets, this proposed rule does not apply if the taxpayer reacquires and again places in service the property during the same taxable year the taxpayer disposed of the property. The proposed regulations also define an *unrelated party* as meaning a person not described in section 179(d)(2)(A) or (B), and §1.179-4(c)(1)(ii) or (iii), or (c)(2).

B. Application to Partnerships

One commenter to the August Proposed Regulations asked for clarification regarding a partner's depreciable interest in property held by a partnership. The Treasury Department and the IRS clarify in these proposed regulations the extent to which a person is treated as having a depreciable interest in property by virtue of being a partner in a partnership that holds the property.

Under the August Proposed Regulations, each partner is treated as having owned and used the partner's proportionate share of partnership property for purposes of determining whether a section 743(b) basis adjustment meets the used property acquisition requirements of section 168(k)(2)(E)(ii). Consistent with this approach, a person should be considered as having a depreciable interest in a portion of property if the person is a partner in the partnership while the partnership owns the property. The same rule should

apply whether a current partner purchases property directly from the partnership or a person acquires property that the partnership previously owned while the person was a partner.

These proposed regulations amend §1.168(k)-2 by adding paragraph (b)(3)(iii)(B)(5) to provide that a partner is considered to have a depreciable interest in a portion of property equal to the partner's total share of depreciation deductions with respect to the property as a percentage of the total depreciation deductions allocated to all partners with respect to that property during the current calendar year and five calendar years immediately prior to the partnership's current placed-in-service year of the property. For this purpose, only the portion of the current calendar year and previous 5-year period during which the partnership owned the property and the person was a partner is taken into account. The Treasury Department and the IRS believe that this provides an accurate reflection of the partner's prior depreciable interest in the property.

C. Series of Related Transactions

Section 1.168(k)-2(b)(3)(iii)(C) of the August Proposed Regulations provides that, in the case of a series of related transactions, property is treated as directly transferred from the original transferor to the ultimate transferee, and the relationship between the original transferor and the ultimate transferee is tested immediately after the last transaction in the series (related transactions rule).

A commenter requested clarification on whether the related transactions rule applies only to test relatedness under section 179(d)(2)(A) or whether this rule applies more broadly for purposes of all of the rules under section 168(k)(2)(E)(ii). For example, if, in a series of related transactions, A transfers property to B in exchange for cash and B transfers property to C in a nonrecognition transaction in exchange for stock or other property, the commenter states that it is not clear whether the related transactions rule is intended to test only the relatedness between A and C under section 179(d)(2)(A). If this rule is intended to apply more broadly, the commenter states that it is not clear whether the rule also determines the

basis of the property or whether B's prior use of the property is relevant.

The commenter also requested clarification on whether the related transactions rule applies to transactions described in §1.168(k)-2(f)(1)(iii) of the August Proposed Regulations (qualified property that is transferred in a transaction described in section 168(i)(7) in the same taxable year that the qualified property is placed in service by the transferor). For example, if a person purchased qualified property and contributed it to a partnership in a transaction described in section 721 in the same taxable year, the commenter questioned whether the related transactions rule would treat the transfer as occurring directly between the original seller and the partnership, assuming that the initial acquisition of the property by the person and the person's transfer of such property to the partnership are part of a series of related transactions.

The Treasury Department and the IRS intended to apply the related transactions rule only for purposes of testing the relatedness of the parties under section 179(d)(2)(A) or (B) in a series of related transactions. The related transactions rule was not intended to test relatedness between the parties involved in a transaction described in section 168(i)(7).

These proposed regulations amend §1.168(k)-2 by revising paragraph (b)(3)(iii)(C) to provide rules for a series of related transactions (proposed related transactions rule). The proposed related transactions rule generally provides that the relationship between the parties under section 179(d)(2)(A) or (B) in a series of related transactions is tested immediately after each step in the series, and between the original transferor and the ultimate transferee immediately after the last transaction in the series.

The Treasury Department and the IRS believe that the relationship between the parties in a series of related transactions should not be tested in certain cases. Accordingly, the proposed related transactions rule provides that a party in the series that is neither the original transferor nor the ultimate transferee is disregarded in applying the relatedness test if the party placed in service and disposed of the property in the party's same taxable year or did not place the property in ser-

vice. The proposed related transactions rule also provides that any step in a series of related transactions that is neither the original step nor the ultimate step is disregarded for purposes of testing relatedness if the step is a transaction described in §1.168(k)-2(g)(1)(iii) (that is, a transfer of property in a transaction described in section 168(i)(7) in the same taxable year that the property is placed in service by the transferor) (§1.168(k)-2(f)(1)(iii) of the August Proposed Regulations). Finally, these proposed regulations provide that the proposed related transactions rule does not apply when all transactions in the series are described in §1.168(k)-2(g)(1)(iii) or to a syndication transaction described in §1.168(k)-2(b)(3)(vi).

The commenter also requested clarification on the application of the related transactions rule in transactions involving sections 179(d)(2)(B) and 1563. For example, if there is a series of related transactions involving a sale of qualified property between two corporations that also become members of the same controlled group, section 179(d)(2)(B) would require testing whether the two corporations are component members of the same controlled group for purposes of section 1563. Under section 1563 and the regulations issued thereunder, a corporation is generally a component member of a controlled group if it is a member of the controlled group for at least one half of the days in the relevant taxable year. See §1.1563-1(b). If the corporations both become members of the controlled group pursuant to a series of related transactions ending in the first half of the taxable year, the corporations should be component members for purposes of section 179(d)(2)(B). However, if the series of related transactions ends in the second half of the taxable year, the commenter questioned whether the related transactions rule applies to treat the two corporations as non-members prior to the end of the series of related transactions, in which case the purchaser of the qualified property may be eligible for immediate expensing (setting aside the potential application of section 179(d)(2)(A)).

The Treasury Department and the IRS also received comments concerning the application of section 179(d)(2)(B) to *Example 21* of §1.168(k)-2(b)(3)(vi) in the August Proposed Regulations. In re-

sponse, the Treasury Department and the IRS have proposed new rules covering the application of section 179(d)(2)(B) to acquisitions of depreciable property between members of the same consolidated group, as explained in the following section of this Explanation of Provisions.

D. Application to Members of a Consolidated Group

i. Overview of Used Property Acquisition Requirements

Section 1.168(k)-2(b)(3)(iii)(A) of the August Proposed Regulations and the Final Regulations lists the following three requirements that must be satisfied in order for acquisitions of used property to qualify for the additional first year depreciation deduction (used property acquisition requirements). First, the property must not have been used by the taxpayer or a predecessor at any time prior to the acquisition (No Prior Use Requirement). Second, the acquisition of the property must satisfy §1.168(k)-2(b)(3)(iii)(A)(2) of the August Proposed Regulations and the Final Regulations, which requires that (a) the property was not acquired from a related person (within the meaning of section 179(d)(2)(A) and §1.179-4(c)(1)(ii)) (Related Party Requirement), (b) the property was not acquired by one component member of a controlled group from another component member of the same controlled group (Component Member Requirement), and (c) the basis of the property in the hands of the acquirer is not determined, in whole or in part, by reference to the adjusted basis in the hands of the transferor. Third, the acquisition of the property must meet the requirements of section 179(d)(3) and §1.179-4(d) (concerning like-kind exchanges and involuntary conversions).

ii. Application of the Used Property Acquisition Requirements to Consolidated Groups

Section 1.168(k)-2(b)(3)(iii)(B)(3) of the August Proposed Regulations provides special rules applying the No Prior Use Requirement to consolidated groups. Section 1.168(k)-2(b)(3)(iii)(B)(3)(i) of the August Proposed Regulations treats a

member that acquires depreciable property as having a prior depreciable interest in such property if the consolidated group had a depreciable interest at any time prior to the member's acquisition of the property (Group Prior Use Rule). For these purposes, a consolidated group is treated as having a depreciable interest in property during the period in which any current or previous member of the consolidated group had a depreciable interest in the property while a member of the consolidated group. Section 1.168(k)-2(b)(3)(iii)(B)(3)(ii) of the August Proposed Regulations provides that, for purposes of applying the No Prior Use Requirement, a member is treated as having a depreciable interest in property prior to the time of its acquisition if, as part of a series of related transactions, the property is acquired by a member of a consolidated group and a corporation that had a depreciable interest in the property becomes a member of that consolidated group (Stock and Asset Acquisition Rule). For purposes of applying these two rules, §1.168(k)-2(b)(3)(iii)(B)(3)(iii) of the August Proposed Regulations provides that, if the acquisition of property is part of a series of related transactions that also includes one or more transactions in which the transferee of the property ceases to be a member of a consolidated group, then whether the taxpayer is a member of a consolidated group is tested immediately after the last transaction in the series.

Commenters have asked for clarification regarding the application of the Group Prior Use Rule to situations in which a consolidated group terminates as a result of all of its members joining another consolidated group, including as a result of a reverse acquisition as defined in §1.1502-75(d)(3). By its terms, the Group Prior Use Rule applies only to the acquisition of property by a member of a consolidated group. Thus, the Treasury Department and the IRS have determined that this rule should apply only as long as the consolidated group remains in existence, as determined under §1.1502-75(d) and other applicable law.

Several commenters also have requested confirmation that a member of a consolidated group that is treated as having a depreciable interest in property solely as a result of the application of the Group Prior

Use Rule does not continue to be treated under that rule as having a depreciable interest in the property after the member leaves the consolidated group (that is, deconsolidates). Commenters have noted that, if a former member continues to be treated as having a depreciable interest in the property after deconsolidation, the Stock and Asset Acquisition Rule could apply whenever one consolidated group acquires from another consolidated group both qualified property and the stock of a member of that second consolidated group (the target member), even if the target member had no actual depreciable interest in the qualified property (as opposed to a depreciable interest arising solely from the application of the Group Prior Use Rule).

The Treasury Department and the IRS did not intend the Group Prior Use Rule to continue to apply to a member of a consolidated group after the member leaves that consolidated group. By its terms, the Group Prior Use Rule applies only as long as a corporation remains a member of a consolidated group. Therefore, when a member deconsolidates, it does not continue to be treated under that rule as having a depreciable interest in the property. Accordingly, a departing member does not continue to have a depreciable interest in the property unless it actually owned such property.

Further, the Treasury Department and the IRS intended the Stock and Asset Acquisition Rule to apply only when the member whose stock is acquired had an actual depreciable interest in the qualified property that also is acquired as part of the same series of related transactions. Accordingly, these proposed regulations clarify that the phrase “a corporation that had a depreciable interest in the property” in the Stock and Asset Acquisition Rule refers only to a corporation that has such an interest without regard to the application of the Group Prior Use Rule.

iii. Sales of Property Between Members of the Same Consolidated Group (*Example 21* in §1.168(k)-2(b)(3)(vi) of the August Proposed Regulations)

The Treasury Department and the IRS have received comments regarding the interaction of the August Proposed Regulations for consolidated groups with

the statutorily prescribed Related Party Requirement and Component Member Requirement, as illustrated by *Example 21* in §1.168(k)-2(b)(3)(vi) of the August Proposed Regulations (Former *Example 21*). Generally, a corporation qualifies as a component member of a controlled group if the corporation was a member of such controlled group during the majority of the corporation’s taxable year. See section 1563(b). In addition, the taxable year of a member of a consolidated group ends for all Federal income tax purposes at the end of the day on which its status as a member changes. See §1.1502-76(b). Therefore, commenters have questioned how the August Proposed Regulations for consolidated groups could apply to treat the Component Member Requirement as satisfied if a member acquires depreciable property from another member of the same consolidated group (selling group) and, as part of an integrated plan that includes the acquisition, the acquiring member deconsolidates from the selling group.

In Former *Example 21*, Parent is the common parent of a consolidated group that includes F Corporation (F) and G Corporation (G). G has a depreciable interest in certain equipment (Equipment #3). As part of a series of related transactions, (1) G sells Equipment #3 to F, and then (2) Parent sells all of its F stock to X Corporation (X), the common parent of an unrelated consolidated group. Based on those facts, Former *Example 21* concludes that the Group Prior Use Rule does not apply to treat F as previously having a depreciable interest in Equipment #3 because F’s status as a member of the Parent consolidated group is tested immediately after the last transaction in the related series, at which point F has ceased to be a member of the Parent consolidated group. Former *Example 21* relies on the same analysis to conclude that the Related Party Requirement and Component Member Requirement are also satisfied, and that, assuming all other relevant requirements are satisfied, F would be eligible to claim the additional first year depreciation deduction for Equipment #3.

Commenters also have requested guidance concerning the amount, location, and timing of the additional first year depreciation deduction in transactions similar to the transaction described in Former

Example 21. In particular, commenters have asked whether the deduction should be reported on the consolidated return of the Parent consolidated group (that is, the selling group) or on the consolidated return of the X consolidated group (that is, the acquiring group), and whether the deduction would be limited by section 168(i)(7). Commenters have noted that, if F were treated as placing Equipment #3 in service while a member of the Parent consolidated group, the deduction might be reported on the consolidated return of the Parent group. In addition, because the transaction between F and G is an inter-company transaction, section 168(i)(7)(B)(ii) might apply to limit the amount of the deduction to an amount equaling G’s gain from the transaction. One commenter further noted that, even if section 168(i)(7)(B)(ii) did not apply to the transaction, any amount of the deduction in excess of G’s gain nevertheless might be disallowed under §1.1502-13 as a noncapital, nondeductible amount.

Commenters have asserted that these potential results regarding the location (the Parent consolidated group) and the amount (an amount not in excess of G’s gain) of the deduction would be improper based on the legislative history of section 168(k), which indicates that Congress intended to stimulate economic activity and promote capital investment. See H. Rept. 115-409, at 232 (2017) (“The Committee believes that providing full expensing for certain business assets lowers the cost of capital for tangible property used in a trade or business. With lower costs of capital, the Committee believes that businesses will be encouraged to purchase equipment and other assets, which will promote capital investment and provide economic growth.”); H. Rept. 107-251, at 20 (2001) (“The Committee believes that allowing additional first-year depreciation will accelerate purchases of equipment, promote capital investment, modernization, and growth, and will help to spur an economic recovery.”).

The Treasury Department and the IRS agree with commenters that, in situations similar to Former *Example 21*, the additional first year depreciation deduction should be reported on the consolidated return of the acquiring group rather than the selling group. With respect to Former

Example 21, the Treasury Department and the IRS note that F made the economic outlay for Equipment #3, which was included in the amount paid by X for F's stock. Additionally, F's acquisition of Equipment #3 and Parent's sale of the F stock to X occur as part of the same series of related transactions; thus, at the time of F's acquisition of Equipment #3, the parties expected F to deconsolidate from the Parent consolidated group, and the substance of the transaction is the same as if F first became a member of the X consolidated group and then acquired Equipment #3. Furthermore, F's purchase of Equipment #3 is the type of activity that section 168(k) was intended to encourage—if F had become a member of the X consolidated group before purchasing Equipment #3, it is clear that F, as a member of the X consolidated group, would be allowed the deduction in its full amount.

Moreover, in circumstances similar to Former *Example 21*, the statute and regulations disregard a transitory acquisition of depreciable property when the property is acquired and disposed of within 90 calendar days. See section 168(k)(2)(E)(iii) and §1.168(k)-2(b)(3)(vi) and (b)(4)(iv) (concerning syndication transactions) of the Final Regulations; see also §1.168(k)-2(b)(3)(iii)(B)(4) of these proposed regulations (concerning de minimis uses of property).

To ensure that the additional first year depreciation deduction is reported on the acquiring group's consolidated return in circumstances like those described in Former *Example 21*, §1.168(k)-2(b)(3)(v)(C) of these proposed regulations (Proposed Consolidated Acquisition Rule) provides that, if a member of a consolidated group acquires depreciable property from another member of the same consolidated group (that is, the selling group) in a taxable transaction, and if the transferee member ceases to be a member of the selling group in a series of related transactions that includes the property acquisition within 90 calendar days of the date of the property acquisition, then (1) the disposition and acquisition of the property are treated as occurring one day after the date on which the transferee member ceases to be a member of the selling group (Deconsolidation Date) for all Federal income tax purposes, and (2) the transferee member is treated as

placing the depreciable property in service not earlier than one day after the Deconsolidation Date for purposes of claiming depreciation or the investment credit.

The Proposed Consolidated Acquisition Rule would ensure that the used property acquisition requirements, including the No Prior Use Requirement and the Related Party Requirement, are satisfied in cases similar to Former *Example 21*. With respect to the No Prior Use Requirement, because the proposed rule treats the transferee member as acquiring the property after it ceases to be a member of the selling group, the transferee member is not attributed the selling group's usage of the property under the Group Prior Use Rule. The Related Party Requirement and Component Member Requirements would be tested using the same analysis.

The Proposed Consolidated Acquisition Rule applies the same treatment for purposes of determining whether the transaction is covered by section 168(i)(7)(B)(ii). Therefore, because the acquisition is not treated as occurring between members of the same consolidated group, if the transferee member is eligible to claim the additional first year depreciation deduction, then section 168(i)(7)(B)(ii) will not apply to limit the amount of the deduction.

In order to allow the deduction to the appropriate party, the Proposed Consolidated Acquisition Rule also provides that the transferee member is treated as placing the property in service not earlier than one day after the Deconsolidation Date for purposes of sections 167 and 168 and §§1.46-3(d) and 1.167(a)-11(e)(1). In so providing, the Treasury Department and the IRS intend to prohibit the transferee member from claiming the additional first year depreciation deduction on the selling group's consolidated return. The rule also prevents the transferee member from claiming regular depreciation or the investment credit with respect to the acquired property during the period after the transferee member acquires the property but before it leaves the selling group. *Example 28* (that is, revised Former *Example 21*) in proposed §1.168(k)-2(b)(3)(vii)(BB) illustrates the application of the Proposed Consolidated Acquisition Rule to the acquisition of depreciable property by one member of a consolidated group

from another member of the same consolidated group.

iv. Deemed Acquisitions of Depreciable Property Between Members of the Same Consolidated Group

Commenters have noted that issues similar to those in Former *Example 21* also arise in the context of deemed acquisitions of property within a consolidated group resulting from an election under either section 338(h)(10) or section 336(e). The Treasury Department and the IRS have determined that deemed acquisitions of property should be treated the same as actual acquisitions of property. Thus, §1.168(k)-2(b)(3)(v)(D) of these proposed regulations provides a rule (Proposed Consolidated Deemed Acquisition Rule) that applies if (1) the transferee member acquires the stock of another member of the same group that holds depreciable property (target) in a qualified stock purchase or a qualified stock disposition for which a section 338 election or a section 336(e) election for a disposition described in §1.336-2(b)(1), respectively, is made, and (2) the transferee member and target cease to be members of the consolidated group within 90 calendar days of the acquisition date (within the meaning of §1.338-2(c)(1)) or disposition date (within the meaning of §1.336-1(b)(8)) as part of the same series of related transactions that includes the acquisition. The Proposed Consolidated Deemed Acquisition Rule does not apply to qualified stock dispositions described in section 355(d)(2) or (e)(2) because the rules applicable to such dispositions do not treat a new target corporation as acquiring assets from an unrelated person. See §1.336-2(b)(2).

If the Proposed Consolidated Deemed Acquisition Rule applies, then (a) the acquisition date or disposition date, as applicable, is treated as the date that is one day after the date on which the transferee member and target cease to be members of the consolidated group (Deconsolidation Date) for all Federal income tax purposes, and (b) new target is treated as placing the depreciable property in service not earlier than one day after the Deconsolidation Date for purposes of sections 167 and 168 and §§1.46-3(d) and 1.167(a)-11(e)(1).

Without the proposed rule, new target might be treated as having a depreciable interest in the assets new target is deemed to acquire by virtue of the Group Prior Use Rule because old target, a member of the same consolidated group, had a depreciable interest in those assets. If applicable, the proposed rule prevents new target from being treated as having a depreciable interest in the assets by moving the acquisition date or disposition date to the day after the Deconsolidation Date. New target is therefore a member of the acquiring group at the time it is deemed to acquire the assets. Similar to the Proposed Consolidated Acquisition Rule, this deemed acquisition rule also provides that the transferee member is treated as placing the property in service not earlier than one day after the Deconsolidation Date for purposes of sections 167 and 168 and §§1.46-3(d) and 1.167(a)-11(e)(1). *Example 29* in proposed §1.168(k)-2(b)(3)(vii) (CC) illustrates the application of the rule to the deemed acquisition of depreciable property by one member of a consolidated group from another member of the same consolidated group pursuant to a section 338(h)(10) election.

Neither the Proposed Consolidated Acquisition Rule nor the Proposed Consolidated Deemed Acquisition Rule applies if the property that is acquired (or deemed acquired) is subsequently disposed of by the transferee member or new target, respectively, in a transaction that is part of the same series of related transactions as the actual or deemed acquisition of the property. For special rules governing the transfer of property in a series of related transactions, see §1.168(k)-2(b)(3)(iii)(C) of these proposed regulations. For special rules governing property placed in service and disposed of in the same taxable year, see §1.168(k)-2(g)(1).

3. Acquisition of Property

A. Definition of Binding Contract for Acquisition of Entity

The Treasury Department and the IRS are aware that taxpayers and practitioners are having difficulty applying the binding contract rules in the August Proposed Regulations to transactions involving the acquisition of an entity. Because those

rules were written to apply to the purchase of an asset instead of an entity, the Treasury Department and the IRS recognize that a binding contract rule for an acquisition of a trade or business, or an entity, is needed. Accordingly, these proposed regulations amend §1.168(k)-2 by adding paragraph (b)(5)(iii)(G) to provide that a contract to acquire all or substantially all of the assets of a trade or business or to acquire an entity (for example, a corporation, a partnership, or a limited liability company) is binding if it is enforceable under State law against the parties to the contract. The presence of a condition outside the control of the parties, including, for example, regulatory agency approval, will not prevent the contract from being a binding contract. Further, the fact that insubstantial terms remain to be negotiated by the parties to the contract, or that customary conditions remain to be satisfied, does not prevent the contract from being a binding contract. This proposed rule also applies to a contract for the sale of the stock of a corporation that is treated as an asset sale as a result of an election under section 338.

B. Property Not Acquired Pursuant to a Written Binding Contract

The Treasury Department and the IRS also are aware that, in some cases, a taxpayer may acquire property that was not pursuant to a written binding contract. If such property is not self-constructed property, a qualified film, television, or live theatrical production, or a specified plant, these proposed regulations amend §1.168(k)-2 by adding paragraph (b)(5)(v) to provide that the acquisition date of property acquired pursuant to a contract that is not a written binding contract is the date on which the taxpayer paid or incurred more than 10 percent of the total cost of the property, excluding the cost of any land and preliminary activities such as planning and designing, securing financing, exploring, or researching. This 10-percent proposed rule is the same as the safe harbor provided in §1.168(k)-2(b)(5)(iv)(B)(2) of the Final Regulations for determining the acquisition date of self-constructed property. This proposed rule does not apply to the acquisition of a trade or business, or an entity. The Treasury De-

partment and the IRS request comments on this proposed rule.

4. Components

Multiple commenters to the August Proposed Regulations requested an election similar to the one provided in section 3.02(2)(b) of Rev. Proc. 2011-26 (2011-16 I.R.B. 664 (April 18, 2011)) for components acquired or self-constructed after September 27, 2017, of larger self-constructed property for which the manufacture, construction, or production of the larger self-constructed property begins before September 28, 2017.

The Treasury Department and the IRS have determined that it is appropriate to allow a taxpayer to elect to treat one or more components acquired or self-constructed after September 27, 2017, of certain larger self-constructed property as being eligible for the additional first year depreciation deduction under section 168(k). The larger self-constructed property must be qualified property under section 168(k)(2), as in effect before the enactment of the Act, for which the manufacture, construction, or production began before September 28, 2017. However, the election is not available for components of larger self-constructed property when such property is not eligible for any additional first year depreciation deduction under section 168(k) (for example, property described in section 168(k)(9) and placed in service by the taxpayer in any taxable year beginning after December 31, 2017, or qualified improvement property placed in service by the taxpayer after December 31, 2017). These proposed regulations amend §1.168(k)-2 by adding paragraph (c) to provide for this election. These proposed regulations also provide rules regarding installation costs and the determination of the basis attributable to the manufacture, construction, or production before January 1, 2020, for longer production period property or certain aircraft property described in section 168(k)(2)(B) or (C). Additionally, these proposed regulations provide the time and manner of making the election, and examples to illustrate the proposed rules.

These proposed regulations also amend §1.168(k)-2(e)(1)(iii) to provide rules regarding the determination of the basis

attributable to the manufacture, construction, or production before January 1, 2027, for longer production period property or certain aircraft property described in section 168(k)(2)(B) or (C).

Commenters to the August Proposed Regulations requested guidance on whether property acquired before September 28, 2017, by a trade or business described in section 168(k)(9)(A) is eligible for the additional first year depreciation deduction provided by section 168(k) as in effect before the enactment of the Act. Another commenter requested clarification on whether any of the costs of property acquired before September 28, 2017, pursuant to a written binding contract, and placed in service after 2017 are eligible for the additional first year depreciation deduction under section 168(k). Property acquired before September 28, 2017, is eligible for the additional first year depreciation deduction provided by section 168(k) as in effect before the enactment of the Act provided such property is qualified property under section 168(k) as in effect before the enactment of the Act. However, if the taxpayer makes the election in proposed §1.168(k)-2(c), as described above, for components acquired or self-constructed after September 27, 2017, those components are eligible for the additional first year depreciation deduction under section 168(k). Such election, however, does not apply to, among other things, property described in section 168(k)(9) and placed in service in a taxable year beginning after December 31, 2017.

5. Special Rules: Mid-quarter Convention

The Treasury Department and the IRS are aware that taxpayers and practitioners have questioned whether the unadjusted depreciable basis of qualified property for which the additional first year depreciation deduction is claimed is taken into account in determining whether the mid-quarter convention under section 168(d) and §1.168(d)-1 applies for the taxable year. The Treasury Department and the IRS agree that a rule is necessary and that it should be consistent with the definition of depreciable basis in §1.168(d)-1(b)(4). Accordingly, the proposed regulations amend §1.168(k)-2 by adding paragraph (g)(11) to provide that in determining

whether the mid-quarter convention applies for a taxable year under section 168(d)(3) and §1.168(d)-1, the depreciable basis, as defined in §1.168(d)-1(b)(4), for the taxable year the qualified property is placed in service by the taxpayer, is not reduced by the allowed or allowable additional first year depreciation deduction for that taxable year.

Proposed Applicability Date

These regulations are proposed to apply to qualified property placed in service or planted or grafted, as applicable, by the taxpayer during or after the taxpayer's taxable year that includes the date of publication of a Treasury decision adopting these rules as final regulations in the **Federal Register**. These regulations also are proposed to apply to components acquired or self-constructed after September 27, 2017, of larger self-constructed property for which the manufacture, construction, or production begins before September 28, 2017, and that is qualified property under section 168(k)(2) as in effect before the enactment of the Act and placed in service by the taxpayer during or after the taxpayer's taxable year that includes the date of publication of a Treasury decision adopting these rules as final regulations in the **Federal Register**. Pending the issuance of final regulations, a taxpayer may choose to rely on these proposed regulations, in their entirety, to qualified property acquired and placed in service or planted or grafted, as applicable, after September 27, 2017, by the taxpayer during taxable years ending on or after September 28, 2017. Pending the issuance of final regulations, a taxpayer also may choose to rely on these proposed regulations, in their entirety, to components acquired or self-constructed after September 27, 2017, of larger self-constructed property for which the manufacture, construction, or production begins before September 28, 2017, and that is qualified property under section 168(k)(2) as in effect before the enactment of the Act and placed in service by the taxpayer during taxable years ending on or after September 28, 2017. If a taxpayer chooses to rely on these proposed regulations, the taxpayer must consistently apply all rules of these proposed regulations.

Special Analyses

I. Regulatory Planning and Review – Economic Analysis

Executive Orders 12866 and 13563 direct agencies to assess costs and benefits of available regulatory alternatives and, if regulation is necessary, to select regulatory approaches that maximize net benefits (including (i) potential economic, environmental, and public health and safety effects, (ii) potential distributive impacts, and (iii) equity). Executive Order 13563 emphasizes the importance of quantifying both costs and benefits, reducing costs, harmonizing rules, and promoting flexibility.

These proposed regulations have been designated as subject to review under Executive Order 12866 pursuant to the Memorandum of Agreement (April 11, 2018) (MOA) between the Treasury Department and the Office of Management and Budget (OMB) regarding review of tax regulations. The Office of Information and Regulatory Affairs has designated these proposed regulations as significant under section 1(b) of the MOA. Accordingly, the OMB has reviewed these proposed regulations.

A. Background

i. Bonus Depreciation Generally

In general, section 168(k) allows taxpayers to immediately deduct some portion of investment in certain types of physical capital, what is colloquially known as bonus depreciation. The Act changed section 168(k) in several ways. Arguably most substantially, the Act increased the bonus percentage as it applies to property generally acquired after September 27, 2017, which accelerates depreciation deductions. The Act also removed the “original use” requirement, meaning that taxpayers could claim bonus depreciation on “used” property. The Act made several other modest changes to the operation of section 168(k). First, it excluded from the definition of qualified property any property used by rate-regulated utilities and firms (primarily automobile dealerships) with “floor plan financing indebtedness” as defined under section 163(j). Further-

more, section 168(k)(2)(a)(ii)(IV) and (V) allowed qualified film, television, and live theatrical productions (as defined under Section 181) to qualify for bonus depreciation.

The regulations under §1.168(k)-2 generally provide structure and clarity for the implementation of section 168(k). However, Treasury and the IRS determined that there remained several outstanding issues requiring clarification that should be subject to notice and comment. First, these proposed regulations address some ambiguities related to the operation of section 168(k)(9), which describes some property that is ineligible for bonus depreciation. Second, these proposed regulations create a de minimis rule which provides that a taxpayer will not be deemed to have had a prior depreciable interest in a property – and thus that property will be eligible for bonus depreciation in that taxpayer’s hands – if the taxpayer previously disposed of that property within 90 days of the date on which that property was placed in service. Third, these proposed regulations clarify the interpretation of an example in the August Proposed Regulations regarding an asset acquisition as part of a sale of a member of a controlled group from one group to another. Fourth, these proposed regulations modify the treatment of series of related transactions. Finally, these proposed regulations provide that certain components of larger self-constructed property can be eligible for the increased bonus depreciation percentage even if the construction of such larger self-constructed property began before September 28, 2017.

B.No-action Baseline

The Treasury Department and the IRS have assessed the benefits and costs of the proposed regulations relative to a no-action baseline reflecting anticipated Federal income tax-related behavior in the absence of these proposed regulations.

C. Economic Analysis of NPRM

This section describes the main provisions of these proposed regulations and provides a qualitative economic analysis of each one.

i. Property Excluded from Bonus Depreciation by Section 168(k)(9)

As discussed above, section 168(k)(9) provides that property used by certain businesses is not eligible for bonus depreciation. These businesses include certain rate-regulated utilities and motor vehicle dealerships with floor plan financing indebtedness.

These proposed regulations first clarify that those taxpayers that lease property to such businesses described by section 168(k)(9) may claim bonus depreciation, so long as other requirements of section 168(k) are met. This approach broadly follows the existing normalization rules (which provide generally for the reconciliation of tax income and book income for regulatory purposes for utilities), which provides that lessors to public utilities are not bound by such rules so long as they themselves are not a public utility. The Treasury Department and the IRS project that this guidance will be easy for taxpayers to interpret and comply with. Additionally, this decision allows businesses to receive some share of the economic benefit of section 168(k). To the extent that lessors can claim bonus depreciation, it is plausible that the market-clearing lease price for such assets will fall, potentially enabling some expansions of output and contributing to economic growth.

These proposed regulations next clarify which businesses fall under the umbrella of section 168(k)(9)(A) (utilities) and section 168(k)(9)(B) (dealerships with floor plan financing indebtedness). For utilities, these proposed regulations clarify that the “primary use” of an item described in the Code is consistent with how primary use is determined in existing regulations under section 167. This application should be familiar to taxpayers, and thus relatively easy to comply with.

The statutory language of section 168(k)(9)(B) is somewhat more ambiguous, and thus more substantive clarifications were necessary. First, section 168(k)(9)(B) provides that dealerships with floor plan financing indebtedness are ineligible for bonus depreciation “if the floor plan financing interest was taken into account under [section 163(j)(1)(C)].” These proposed regulations clarify that such interest is in fact “taken into account” only if the

firm in fact received a benefit from section 163(j)(1)(C) – i.e., if total business interest expense (including floor plan financing interest) exceeds business interest income plus 30 percent of adjusted taxable income. This decision allows more firms to claim bonus depreciation than if the Treasury Department and the IRS had made the opposite interpretation (deeming all dealerships with floor plan financing interest to be ineligible for bonus depreciation, regardless of whether the firm received a benefit from section 163(j)(1)(C)).

The Treasury Department and the IRS have undertaken an analysis of the investment effects of this provision, under the assumption that 10 to 50 percent of affected taxpayers would have come to the opposite interpretation in the absence of the proposed regulations. Using tax return data and parameters from the literature on the effect of bonus depreciation on investment, this analysis has found that this provision would increase investment by an annual maximum of \$20 to \$90 million, although this range would likely decrease over time as uncertainty over the interpretation of the statute is resolved. Additionally, these proposed regulations will resolve a substantial compliance uncertainty facing these taxpayers.

An additional ambiguity in section 168(k)(9)(B) pertains to the length of time that the section applies to a given firm. The section refers to a “trade or business that has had floor plan financing indebtedness ... if the floor plan financing interest related to such indebtedness was taken into account under [section 163(j)(1)(C)]”. Consider a firm (*Example A*) that received a benefit from section 163(j)(C)(1) in tax year 2018 (meaning that its interest deduction would have been smaller if not for section 163(j)(C)(1)) but not in tax year 2019 or any other later year. One interpretation of the statute would deem that firm forever ineligible for bonus depreciation, in 2019 and later. The Treasury Department and the IRS came to the opposite conclusion and deemed that section 168(k)(9)(B) is determined on an annual basis: for example, the firm in *Example A* of this part of the Special Analysis section would not be eligible for bonus depreciation in 2018, but so long as the other requirements were met, it would be eligible for bonus depreciation in 2019.

As with the interpretation of “taken into account,” this interpretation enables more firms to be eligible for bonus depreciation in more years, potentially increasing investment by such firms. The Treasury Department and the IRS expect that some taxpayers would have come to a different conclusion regarding the interpretation of this timing in the absence of these proposed regulations. Therefore, this provision could also have some economic effects. The Treasury Department and the IRS engaged in an analysis on these effects based on historical tax data, parameter values from the economic literature for the effect of bonus depreciation on investment, and assumptions regarding taxpayer interpretations in the absence of these proposed regulations. The result of this analysis projects that this provision will cause investment to increase in this industry by no greater than \$55 million in any year, and approximately \$25 million per year on average over the period from 2019 to 2028. The Treasury Department and the IRS additionally project that some share of this increased investment will reduce investment in other industries through crowd-out effects.

Importantly, the estimated effect of this provision interacts substantially with the rule that floor plan financing is “taken into account” only if the firm in fact received a benefit from section 163(j)(1)(C). In the absence of the proposed regulations, the Treasury Department and the IRS project that some share of taxpayers in this industry would have interpreted section 168(k)(9)(B) as rendering them ineligible for bonus depreciation in substantially all circumstances. Therefore, the effect of both provisions together is less than the sum of each of the provisions considered independently. In total, the Treasury Department and the IRS have determined that the effect of both rules related to section 168(k)(9)(B), when considered together, would have a maximum annual effect on investment in the range of \$65 million to \$90 million and declining over time as uncertainty over the interpretation of the statute is resolved.

ii. Prior Depreciable Interest

In general, to be eligible for bonus depreciation, a given property may not

have been owned by the same firm in the past. This requirement was instituted by Congress in order to prevent “churning” of assets, whereby a firm could sell and soon thereafter repurchase the same asset in order to claim the 100 percent deduction. The August Proposed Regulations defined “ownership” for this purpose as having a prior depreciable interest. Section 1.168(k)-2 finalizes this interpretation. These proposed regulations introduce an exception, providing that a taxpayer does not have a depreciable interest in a given property if the taxpayer disposed of the property within 90 days of the initial date when the property was placed in service (so long as the asset is not repurchased and placed in service again within the same taxable year). The Treasury Department and the IRS primarily instituted this rule in order to coordinate with the syndication transaction rules of section 168(k)(E)(2)(iii). The Treasury Department and the IRS do not anticipate substantial economic effects of this provision. Nevertheless, it will generally have the effect of causing more property to be eligible for bonus depreciation (increasing incentives to invest), while minimizing incentives for wasteful churning of assets.

Furthermore, these proposed regulations clarify that partners in a partnership hold a depreciable interest in the property held by that partnership, and that the share of the property to which this applies equals the partner’s share of the depreciation deductions of the partnership over a certain period. The Treasury Department and the IRS have determined that this provides an accurate reflection of the partner’s prior depreciable interest in the property, and therefore aligns tax consequences and economic consequences, which is generally favorable for economic efficiency. However, as is the case with the “prior use” rules generally, the Treasury Department and the IRS do not project this provision to substantially affect behavior.

iii. Group Prior Use Rule

These proposed regulations clarify several aspects of the “Group Prior Use Rule.” Under that rule, all members of a consolidated group are treated as having had a depreciable interest in a property

if any member of the consolidated group had such a depreciable interest. First, these proposed regulations clarify that the rule ceases to be in effect once the consolidated group terminates as a result of joining another consolidated group. Second, these proposed regulations clarify that the Group Prior Use Rule does not apply to a corporation after it deconsolidates from the consolidated group, so long as that corporation did not in fact own that property. As is the case with the prior use rules generally, the Treasury Department and the IRS do not anticipate large economic effects as a result of this section of these proposed regulations.

iv. Purchases of Assets as Part of Acquisition of Entire Business

Additionally, these proposed regulations clarify the proper procedure for certain purchases of assets by a given corporation from a related party that are a part of an integrated plan involving the selling of that corporation from one group to another. Specifically, these proposed regulations provide that the deduction for bonus depreciation is allowed in such circumstances, and should be claimed by the acquiring group. These proposed regulations provide for a similar treatment in the case of deemed acquisitions in the case of an election under section 338(h)(10) or section 336(e). These rules cause the tax treatment to reflect the economic reality, in which the acquiring group is bearing the economic outlay of the asset purchase, and that acquiring group had no economic prior depreciable interest. By aligning the tax consequences with the economic allocations, this treatment minimizes potential distortions caused by the anti-churning rules.

v. Component Rule Election

In 2010, Congress increased the bonus percentage from 50 percent to 100 percent for property placed in service between September 9, 2010 and December 31, 2011. In 2011, the IRS issued Revenue Procedure 2011-26 to allow taxpayers to elect to have the 100 percent bonus rate apply to components of larger self-constructed property whose construction began before September 9, 2010, so long

as (1) the components were acquired (or self-constructed) after than that date and (2) the larger self-constructed property itself qualifies for bonus depreciation generally. These proposed regulations provide an analogous rule, replacing September 9, 2010 with September 27, 2017. This provision will allow more property to qualify for 100 percent bonus depreciation. Furthermore, this provision provides neutrality between taxpayers who acquire distinct, smaller pieces of depreciable property and those taxpayers that invest a similar amount in fewer, larger pieces of depreciable property whose construction takes place over a longer period of time. By treating similar taxpayers (and similar choices) similarly, this rule enhances economic efficiency by minimizing tax-related distortions. However, the Treasury Department and the IRS project these rules to have only a modest effect on future economic decisions. These rules affect only taxpayers (1) that acquire (or self-construct) components after the date of enactment of these proposed regulations and (2) for whom the construction of the larger self-constructed property began prior to September 28, 2017 (approximately 21 months ago). The Treasury Department and the IRS expect relatively few taxpayers to be affected by this provision going forward.

vi. Series of Related Transactions

The August Proposed Regulations provided that, in a series of related transactions, the relationship between the transferor and transferee of an asset was determined only after the final transaction in the series (the “Series of Related Transaction Rule”). Commenters had expressed confusion regarding whether this applies to testing whether parties are related under section 179(d)(2), or whether it applies more broadly (e.g., in determining whether the taxpayer had a prior depreciable

interest). These proposed regulations clarify that this Series of Related Transaction Rule is intended only to test the relatedness of two parties.

These proposed regulations further revise the Series of Related Transaction Rule to address its application in various situations. Under these proposed regulations, the relatedness is tested after each step of the series of related transactions, with the substantial exception that any intermediary (i.e., a taxpayer other than the original transferor or ultimate transferee) is disregarded so long as that intermediary (1) never places the property in service or (2) disposes of the property in the same taxable year in which it was placed in service. This would tend to eliminate the benefit of the Series of Related Transaction Rule in cases where intermediate transferees maintained use of the property for a non-trivial length of time. The Treasury Department and the IRS project that this interpretation will prevent abuse. The Treasury Department and the IRS do not predict substantial economic effects of this provision.

vii. Miscellaneous

Lastly, these proposed regulations put forward rules to the extent existing regulations apply in slightly new contexts. In particular, these proposed regulations clarify when a binding contract is in force to acquire all or substantially all the assets of a trade or business. Additionally, consistent with the rules of §1.168(d)-1(b)(4), these proposed regulations provide that, for the purpose of determining whether the mid-quarter convention applies, depreciable basis is not reduced by the amount of bonus depreciation. The Treasury Department and the IRS do not anticipate large economic effects of these clarifications, though the additional clarity of these regulations will likely reduce compliance burdens.

II. Paperwork Reduction Act

The collection of information in these proposed regulations are in proposed §1.168(k)-2(c). The collection of information in proposed §1.168(k)-2(c) is an election that a taxpayer may make to treat one or more components acquired or self-constructed after September 27, 2017, of certain larger self-constructed property as being eligible for the 100-percent additional first year depreciation deduction under section 168(k). The larger self-constructed property must be qualified property under section 168(k)(2) as in effect before the enactment of the Act and for which the manufacture, construction, or production began before September 28, 2017. The election is made by attaching a statement to a Federal income tax return indicating that the taxpayer is making the election under proposed §1.168(k)-2(c) and whether the taxpayer is making the election for all or some of the components described in proposed §1.168(k)-2(c).

For purposes of the Paperwork Reduction Act of 1995 (44 U.S.C. 3507(d)) (PRA), the reporting burden associated with proposed §1.168(k)-2(c) will be reflected in the PRA submission associated with income tax returns in the Form 1120 series, Form 1040 series, Form 1041 series, and Form 1065 series (for OMB control numbers, see chart at the end of this part II of this Special Analysis section). The estimate for the number of impacted filers with respect to the collection of information described in this part is 0 to 137,000 respondents. Historical data was not available to directly estimate the number of impacted filers. This estimate assumes that no more than 10 percent of income tax return filers with a nonzero entry on Form 4562 Line 14 (additional first year depreciation deduction) will make this election (5 percent in the case of filers of Form 1040 series). The IRS estimates the number of affected filers to be the following:

Tax Forms Impacted		
Collection of information	Number of respondents (estimated)	Forms to which the information may be attached
Section 1.168(k)-2(c) Election for components of larger self-constructed property for which the manufacture, construction, or production begins before September 28, 2017	0-137,000	Form 1120 series, Form 1040 series, Form 1041 series, and Form 1065 series

Source: IRS:RAAS:KDA (CDW 6-1-19)

The current status of the PRA submissions related to the tax forms that will be revised as a result of the information collections in the section 168(k) regulations is provided in the accompanying table. As described above, the reporting burdens associated with the information collections in the regulations are included in the aggregated burden estimates for OMB control numbers 1545-0123 (which represents a total estimated burden time for all forms and schedules for corporations of 3.157 billion hours and total estimated monetized costs of \$58.148 billion (\$2017)), 1545-0074 (which represents a total estimated burden time, including all other related forms and schedules for individuals, of 1.784 billion hours and total estimated monetized costs of \$31.764 billion (\$2017)), and 1545-0092 (which represents a total estimated burden time, including all other related forms and schedules for trusts and estates, of 307,844,800 hours and total estimated monetized costs of \$9.950 billion (\$2016)). The overall burden estimates provided for the OMB control numbers

below are aggregate amounts that relate to the entire package of forms associated with the applicable OMB control number and will in the future include, but not isolate, the estimated burden of the tax forms that will be created or revised as a result of the information collections in the regulations. These numbers are therefore unrelated to the future calculations needed to assess the burden imposed by the regulations. These burdens have been reported for other regulations that rely on the same OMB control numbers to conduct information collections under the PRA, and the Treasury Department and the IRS urge readers to recognize that these numbers are duplicates and to guard against over counting the burden that the regulations that cite these OMB control numbers imposed prior to the Act. No burden estimates specific to the forms affected by the regulations are currently available. The Treasury Department and the IRS have not estimated the burden, including that of any new information collections, related to the requirements under the regulations. For the OMB control numbers discussed

above, the Treasury Department and the IRS estimate PRA burdens on a taxpayer-type basis rather than a provision-specific basis. Those estimates would capture changes made by the Act, the final regulations under section 168(k), and those that arise out of discretionary authority exercised in these proposed regulations and other regulations that affect the compliance burden for those forms.

The Treasury Department and the IRS request comments on all aspects of information collection burdens related to the proposed regulations, including estimates for how much time it would take to comply with the paperwork burdens described above for each relevant form and ways for the IRS to minimize the paperwork burden. In addition, when available, drafts of IRS forms are posted for comment at <https://apps.irs.gov/app/picklist/list/draft-TaxForms.htm>. IRS forms are available at <https://www.irs.gov/forms-instructions>. Forms will not be finalized until after they have been approved by OMB under the PRA.

Form	Type of Filer	OMB Number(s)	Status
Form 1040	Individual (NEW Model)	1545-0074	Published in the Federal Register on 7/20/18. Public Comment period closed on 9/18/18. Link: https://www.federalregister.gov/documents/2018/07/20/2018-15627/proposed-collection-comment-request-for-regulation-project
	Trusts and estates	1545-0092	Published in the Federal Register on 4/4/18. Public Comment period closed on 6/4/18. Link: https://www.federalregister.gov/documents/2018/04/04/2018-06892/proposed-collection-comment-request-for-form-1041
Form 1041	Business (NEW Model)	1545-0123	Published in the Federal Register on 10/8/18. Public Comment period closed on 12/10/18. Link: https://www.federalregister.gov/documents/2018/10/09/2018-21846/proposed-collection-comment-request-for-forms-1065-1065-b-1066-1120-1120-c-1120-f-1120-h-1120-nd
	Forms 1065 and 1120		

III. Regulatory Flexibility Act

It is hereby certified that these proposed regulations will not have a significant economic impact on a substantial number of small entities within the meaning of section 601(6) of the Regulatory Flexibility Act (5 U.S.C. chapter 6).

Section 168(k) generally affects taxpayers that own and use depreciable property in their trades or businesses or for

their production of income. The reporting burden in proposed §1.168(k)-2(c) generally affects taxpayers that elect to have the 100 percent additional first year depreciation deduction apply to components that are acquired or self-constructed after September 27, 2017, of depreciable property for which the manufacture, construction, or production began before September 28, 2017, and was completed generally before January 1, 2020. The election is made by

attaching a statement to a Federal income tax return indicating that the taxpayer is making the election under proposed §1.168(k)-2(c) and whether the taxpayer is making this election for all or some of the components described in §1.168(k)-2(c).

For purposes of the PRA, the Treasury Department and the IRS estimate that there are 0 to 181,500 respondents of all sizes that are likely to be impact-

ed by this collection of information. Only a small proportion of these filers are likely to be small entities (business

entities with gross receipts of \$25 million or less pursuant to section 448(c) (1)). The Treasury Department and the

IRS estimate the number of filers affected by proposed §1.168(k)-2(c) to be the following:

Form	Gross receipts of \$25 million or less	Gross receipts over \$25 million
Form 1040	0-12,000 Respondents (estimated)	0-32,500 Respondents (estimated)
Form 1065	0-1,250 Respondents (estimated)	0-35,000 Respondents (estimated)
Form 1120	0-1,750 Respondents (estimated)	0-11,000 Respondents (estimated)
Form 1120S	0-2,500 Respondents (estimated)	0-41,000 Respondents (estimated)
TOTAL	0-29,500 Respondents (estimated)	0-152,000 Respondents (estimated)

Source: IRS:RAAS:KDA (CDW 6-1-19)

Regardless of the number of small entities potentially affected by these proposed regulations, the Treasury Department and the IRS have concluded that proposed §1.168(k)-2(c) will not have a significant economic impact on a substantial number of small entities. As a result of all changes in these proposed regulations, the Treasury Department and the IRS estimate that individual taxpayers who have gross receipts of \$25 million or less and experience an increase in burden will incur an average increase of 0 to 3 hours, and business taxpayers that have gross receipts of \$25 million or less and experience an increase in burden will incur an average increase of 0 to 2 hours (Source: IRS:RAAS (8-28-2019)). Because the election in proposed §1.168(k)-2(c) is one of several changes in these proposed regulations, the Treasury Department and the IRS expect the average increase in burden to be less for the collection of information in proposed §1.168(k)-2(c) than the average increase in burden in the preceding sentence. The Treasury Department and the IRS also note that many taxpayers with gross receipts of \$25 million or less may experience a reduction in burden as a result of all changes in these proposed regulations.

Additionally: (1) Many small businesses are not required to capitalize under section 263(a) the amount paid or

incurred for the acquisition of depreciable tangible property that costs \$5,000 or less if the business has an applicable financial statement or costs \$500 or less if the business does not have an applicable financial statement, pursuant to §1.263(a)-1(f)(1); (2) many small businesses are no longer required to capitalize under section 263A the costs to construct, build, manufacture, install, improve, raise, or grow depreciable property if their average annual gross receipts are \$25,000,000 or less; and (3) a small business that capitalizes costs of depreciable tangible property may deduct under section 179 up to \$1,020,000 (2019 inflation adjusted amount) of the cost of such property placed in service during the taxable year if the total cost of depreciable tangible property placed in service during the taxable year does not exceed \$2,550,000 (2019 inflation adjusted amount). Therefore, the Treasury Department and the IRS have determined that a substantial number of small entities will not be subject to these proposed regulations. Finally, proposed §1.168(k)-2(c) applies only if the taxpayer chooses to make an election to a more favorable rule. Consequently, the Treasury Department and the IRS hereby certify that these proposed regulations will not have a significant economic impact on a substantial number of small entities.

Pursuant to section 7805(f) of the Code, this notice of proposed rulemaking will be submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

IV. Unfunded Mandates Reform Act

Section 202 of the Unfunded Mandates Reform Act of 1995 requires that agencies assess anticipated costs and benefits and take certain other actions before issuing a final rule that includes any Federal mandate that may result in expenditures in any one year by a state, local, or tribal government, in the aggregate, or by the private sector, of \$100 million in 1995 dollars, updated annually for inflation. In 2019, that threshold is approximately \$154 million. These proposed regulations do not include any Federal mandate that may result in expenditures by state, local, or tribal governments, or by the private sector in excess of that threshold.

V. Executive Order 13132: Federalism

Executive Order 13132 (entitled “Federalism”) prohibits an agency from publishing any rule that has federalism implications if the rule either imposes substantial, direct compliance costs on state and local governments, and is not

required by statute, or preempts state law, unless the agency meets the consultation and funding requirements of section 6 of the Executive Order. These proposed regulations do not have federalism implications and do not impose substantial direct compliance costs on state and local governments or preempt state law within the meaning of the Executive Order.

Comments and Public Hearing

Before these proposed regulations are adopted as final regulations, consideration will be given to any comments that are submitted timely to the IRS as prescribed in this preamble under the **ADDRESSES** heading. The Treasury Department and the IRS request comments on all aspects of the proposed rules. All comments will be available at <https://www.regulations.gov> or upon request.

A public hearing is scheduled on November 13, 2019, beginning at 10 a.m. in the Auditorium of the Internal Revenue Building, 1111 Constitution Avenue, NW, Washington, DC 20224. Due to building security procedures, visitors must enter at the Constitution Avenue entrance. In addition, all visitors must present photo identification to enter the building. Because of access restrictions, visitors will not be admitted beyond the immediate entrance area more than 30 minutes before the hearing starts. For more information about having your name placed on the building access list to attend the hearing, see the **FOR FURTHER INFORMATION CONTACT** section of this preamble.

The rules of 26 CFR 601.601(a)(3) apply to the hearing. Persons who wish to present oral comments at the hearing must submit an outline of the topics to be discussed and the time to be devoted to each topic by October 23, 2019. Submit a signed paper or electronic copy of the outline as prescribed in this preamble under the **ADDRESSES** heading. A period of 10 minutes will be allotted to each person making comments. An agenda showing the scheduling of the speakers will be prepared after the deadline for receiving outlines has passed. Copies of the agenda will be available free of charge at the hearing.

If no outline of the topics to be discussed at the hearing is received by October 23, 2019, the public hearing will

be cancelled. If the public hearing is cancelled, a notice of cancellation of the public hearing will be published in the **Federal Register**.

Drafting Information

The principal authors of these proposed regulations are Kathleen Reed and Elizabeth R. Binder of the Office of Associate Chief Counsel (Income Tax and Accounting). However, other personnel from the Treasury Department and the IRS participated in their development.

Partial Withdrawal of Proposed Regulations

Under the authority of 26 U.S.C. 7805 and 26 U.S.C. 1502, §1.168(k)-2(b)(3)(iii)(B)(3)(i) through (iii), §1.168(k)-2(b)(3)(iii)(C), and §1.168(k)-2(b)(3)(vi) *Examples* 18 through 22 of the notice of proposed rulemaking (REG-104397-18) published in the **Federal Register** on August 8, 2018 (83 FR 39292) are withdrawn.

Statement of Availability

IRS Revenue Procedures and Notices cited in this preamble are published in the Internal Revenue Bulletin (or Cumulative Bulletin) and are available from the Superintendent of Documents, U.S. Government Publishing Office, Washington, DC 20402, or by visiting the IRS website at <http://www.irs.gov>.

List of Subjects in 26 CFR Part 1

Income taxes, Reporting and record-keeping requirements.

Proposed Amendments to the Regulations

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

PART 1—INCOME TAXES

Paragraph 1. The authority citation for part 1 is amended by adding an entry for §1.168(k)-2 in numerical order to read in part as follows:

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

* * * * *
Section 1.168(k)-2 also issued under 26 U.S.C. 1502.

Par. 2. Section 1.168(k)-0 is amended by adding entries for §1.168(k)-2(b)(3)(iii)(C), (b)(3)(v), (b)(5)(iii)(G), (b)(5)(v), (c), and (g)(11); and adding an entry for §1.168(k)-2(h)(4) to read as follows:

§1.168(k)-0 Table of contents.

* * * * *

§1.168(k)-2 Additional first year depreciation deduction for property acquired and placed in service after September 27, 2017.

* * * * *

(b) * * *

(3) * * *

(iii) * * *

(C) Special rules for a series of related transactions.

* * * * *

(v) Application to members of a consolidated group.

* * * * *

(5)* * *

(iii) * * *

(G) Acquisition of a trade or business or an entity.

* * * * *

(v) Determination of acquisition date for property not acquired pursuant to a written binding contract.

* * * * *

(c) Election for components of larger self-constructed property for which the manufacture, construction, or production begins before September 28, 2017.

(1) In general.

(2) Eligible larger self-constructed property.

(i) In general.

(ii) Exceptions.

(3) Eligible components.

(i) In general.

(ii) Acquired components.

(iii) Self-constructed components.

(4) Special rules.

(i) Installation costs.

(ii) Property described in section 168(k)(2)(B).

(5) Computation of additional first year depreciation deduction.

(i) Election is made.

(ii) Election is not made.

(6) Time and manner for making election.

(i) Time for making election.

(ii) Manner of making election.

(7) Examples.

* * * *

(g) * * *

(11) Mid-quarter convention.

(h) * * *

(4) Regulation project REG-106808-

19.

Par. 3. Section 1.168(k)-2 is amended by:

1. At the end of paragraph (a)(1), adding “, except as provided in paragraph (c) of this section”;
2. Revising paragraph (b)(2)(ii)(F);
3. Adding three sentences at the end of paragraph (b)(2)(ii)(G);
4. Adding paragraphs (b)(2)(iii)(F), (G), and (H);
5. Adding paragraphs (b)(3)(iii)(B)(4) and (5), (b)(3)(iii)(C), (b)(3)(v), and (b)(3)(vii)(Y) through (HH);
6. Revising the last sentence in paragraph (b)(5)(ii)(A);
7. In the first sentence in paragraph (b)(5)(iii)(A), removing the word “A” at the beginning of the sentence and adding “Except as provided in paragraph (b)(5)(iii)(G) of this section, a” in its place;
8. In the first sentence in paragraph (b)(5)(iii)(B), removing the word “A” at the beginning of the sentence and adding “Except as provided in paragraph (b)(5)(iii)(G) of this section, a” in its place;
9. Adding paragraph (b)(5)(iii)(G);
10. In the penultimate sentence in paragraph (b)(5)(iv)(C)(1), removing the period at the end of the sentence and adding “, except as provided in paragraph (c) of this section.” in its place;
11. In the penultimate sentence in paragraph (b)(5)(iv)(C)(2), removing the period at the end of the sentence and adding “, except as provided in paragraph (c) of this section.” in its place;
12. Adding paragraph (b)(5)(v);
13. Revising the second sentence in paragraph (b)(5)(viii) introductory text;
14. Adding paragraph (c);
15. Adding two sentences at the end of paragraph (e)(1)(iii);
16. Adding paragraph (g)(11);
17. In introductory paragraph (h)(1), removing “paragraphs (h)(2) and (3)” and adding “paragraphs (h)(2), (3), and (4)” in its place; and

18. Adding paragraph (h)(4).

The additions and revisions read as follows:

§1.168(k)-2 Additional first year depreciation deduction for property acquired and placed in service after September 27, 2017.

* * * *

(b) * * *

(2) * * *

(ii) * * *

(F) Primarily used in a trade or business described in section 163(j)(7)(A)(iv), and placed in service by the taxpayer in any taxable year beginning after December 31, 2017. For purposes of section 168(k)(9)(A) and this paragraph (b)(2)(ii)(F), the term *primarily used* has the same meaning as that term is used in §1.167(a)-11(b)(4)(iii)(b) and (e)(3)(iii) for classifying property. This paragraph (b)(2)(ii)(F) does not apply to property that is leased to a trade or business described in section 163(j)(7)(A)(iv) by a lessor’s trade or business that is not described in section 163(j)(7)(A)(iv) for the taxable year; or

(G) * * * Solely for purposes of section 168(k)(9)(B) and this paragraph (b)(2)(ii)(G), floor plan financing interest is not taken into account for the taxable year by a trade or business that has had floor plan financing indebtedness if the sum of the amounts calculated under section 163(j)(1)(A) and (B) for the trade or business for the taxable year equals or exceeds the business interest, as defined in section 163(j)(5), of the trade or business for the taxable year (which includes floor plan financing interest). If the trade or business has taken floor plan financing interest into account pursuant to this paragraph (b)(2)(ii)(G) for a taxable year, this paragraph (b)(2)(ii)(G) applies to any property placed in service by that trade or business in that taxable year. This paragraph (b)(2)(ii)(G) does not apply to property that is leased to a trade or business that has had floor plan financing indebtedness by a lessor’s trade or business that has not had floor plan financing indebtedness during the taxable year or that has had floor plan financing indebtedness but did not take into account floor plan financing interest for the taxable year pursuant to this paragraph (b)(2)(ii)(G).

(iii) * * *

(F) *Example 6.* In 2019, a financial institution buys new equipment for \$1 million and then leases this equipment to a lessee that primarily uses the equipment in a trade or business described in section 163(j)(7)(A)(iv). The financial institution is not described in section 163(j)(7)(A)(iv). As a result, paragraph (b)(2)(ii)(F) of this section does not apply to this new equipment. Assuming all other requirements are met, the financial institution’s purchase price of \$1 million for the new equipment qualifies for the additional first year depreciation deduction under this section.

(G) *Example 7.* In 2019, F, an automobile dealer, buys new computers for \$50,000 for use in its trade or business of selling automobiles. For purposes of section 163(j), F has the following for 2019: \$1,000 of adjusted taxable income, \$40 of business interest income, \$400 of business interest (which includes \$100 of floor plan financing interest). The sum of the amounts calculated under section 163(j)(1)(A) and (B) for F for 2019 is \$340 (\$40 + (\$1,000 x 30 percent)). F’s business interest, which includes floor plan financing interest, for 2019 is \$400. As a result, F’s floor plan financing interest is taken into account by F for 2019 pursuant to paragraph (b)(2)(ii)(G) of this section. Accordingly, F’s purchase price of \$50,000 for the computers does not qualify for the additional first year depreciation deduction under this section.

(H) *Example 8.* The facts are the same as in *Example 7* in paragraph (b)(2)(ii)(G) of this section. In 2020, F buys new copiers for \$30,000 for use in its trade or business of selling automobiles. For purposes of section 163(j), F has the following for 2020: \$1,300 of adjusted taxable income, \$40 of business interest income, \$400 of business interest (which includes \$100 of floor plan financing interest). The sum of the amounts calculated under section 163(j)(1)(A) and (B) for F for 2020 is \$430 (\$40 + (\$1,300 x 30 percent)). F’s business interest, which includes floor plan financing interest, for 2020 is \$400. As a result, F’s floor plan financing interest is not taken into account by F for 2020 pursuant to paragraph (b)(2)(ii)(G) of this section. Assuming all other requirements are met, F’s purchase price of \$30,000 for the copiers qualifies for the additional first year depreciation deduction under this section.

(3) * * *

(iii) * * *

(B) * * *

(4) *De minimis use of property.* If a taxpayer acquires and places in service property, the taxpayer or a predecessor did not previously have a depreciable interest in the property, the taxpayer disposes of the property to an unrelated party within 90 calendar days after the date the property was originally placed in service by the taxpayer, without taking into account the applicable convention, and the taxpayer reacquires and again places in service the property, the taxpayer’s depreciable interest in the property during that 90-day period is not taken into account for determining whether the property was used by the

taxpayer or a predecessor at any time prior to its reacquisition by the taxpayer under paragraphs (b)(3)(iii)(A)(1) and (b)(3)(iii)(B)(1) of this section. This paragraph (b)(3)(iii)(B)(4) does not apply if the taxpayer reacquires and again places in service the property during the same taxable year the taxpayer disposed of the property. For purposes of this paragraph (b)(3)(iii)(B)(4), an *unrelated party* is a person not described in section 179(d)(2)(A) or (B), and §1.179-4(c)(1)(ii) or (iii), or (c)(2).

(5) *Partner's prior depreciable interest in property held by partnership.* Solely for purposes of applying paragraphs (b)(3)(iii)(A)(1) and (b)(3)(iii)(B)(1) and (2) of this section, a person is treated as having a depreciable interest in a portion of property prior to the person's acquisition of the property if the person was a partner in a partnership at any time the partnership owned the property. For purposes of the preceding sentence, the portion of property that a partner is treated as having a depreciable interest in is equal to the total share of depreciation deductions with respect to the property allocated to the partner as a percentage of the total depreciation deductions with respect to that property allocated to all partners during the current calendar year and five calendar years immediately prior to the partnership's current placed-in-service year of the property. If the person was not a partner in the partnership for this entire period, or if the partnership did not own the property for the entire period, only the period during which the person was a partner and the partnership owned the property is taken into account for purposes of determining a partner's share of depreciation deductions.

(C) *Special rules for a series of related transactions—(1) In general.* Solely for purposes of paragraph (b)(3)(iii) of this section, the relationship between parties under section 179(d)(2)(A) or (B) in a series of related transactions is tested immediately after each step in the series, and between the original transferor and the ultimate transferee immediately after the last transaction in the series. A series of related transactions may include, for example, a transfer of partnership assets followed by a transfer of an interest in the partnership that owned the assets; or a disposition of property and disposition,

directly or indirectly, of the transferor or transferee of the property.

(2) *Special rules—(i) Property placed in service and disposed of in same taxable year or property not placed in service.* Any party in a series of related transactions that is neither the original transferor nor the ultimate transferee is disregarded (disregarded party) for purposes of testing the relationships under paragraph (b)(3)(iii)(C)(1) of this section if the party places in service and disposes of the depreciable property subject to the series, other than in a transaction described in paragraph (g)(1)(iii) of this section, during the party's same taxable year or if the party does not place in service the depreciable property subject to the series for use in the party's trade or business or production of income. In this case, the relationship is tested between the party from which the disregarded party acquired the depreciable property and the party to which the disregarded party disposed of the depreciable property. If the series has consecutive disregarded parties, the relationship is tested between the party from which the first disregarded party acquired the depreciable property and the party to which the last disregarded party disposed of the depreciable property. The rules for testing the relationships in paragraph (b)(3)(iii)(C)(1) of this section continue to apply for the other transactions in the series and for the last transaction in the series.

(iv) *Syndication transaction.* This paragraph (b)(3)(iii)(C) does not apply to a syndication transaction described in paragraph (b)(3)(vi) of this section.

(v) *Application of paragraph (g)(1) of this section.* Paragraph (g)(1) of this section applies to each step in a series of related transactions.

* * * * *

(v) *Application to members of a consolidated group—(A) In general.* Solely for purposes of applying paragraph (b)(3)(iii)(A)(1) of this section, if a member of a consolidated group, as defined in §1.1502-1(h), acquires depreciable property in which the group had a depreciable interest at any time prior to the member's acquisition of the property, the member is treated as having a depreciable interest in the property prior to the acquisition. For purposes of this paragraph (b)(3)(v)(A), a consolidated group is treated as having a depreciable interest in property during the time any current or previous member of the group had a depreciable interest in the property while a member of the group.

(B) *Certain acquisitions pursuant to a series of related transactions.* Solely for purposes of applying paragraph (b)(3)(v)(A) of this section, if a series of related transactions includes one or more transactions in which property is acquired by a member of a consolidated group, and one or more transactions in which a corporation that had a depreciable interest in the property, determined without regard to the application of paragraph (b)(3)(v)

(A) of this section, becomes a member of the group, the member that acquires the property is treated as having a depreciable interest in the property prior to the time of its acquisition.

(C) *Sale of depreciable property to a member that leaves the group.* Except as otherwise provided in paragraph (b)(3)(v)(E) of this section, if a member of a consolidated group (transferee member) acquires from another member of the same group (transferor member) depreciable property in an acquisition meeting the requirements of paragraph (b)(3)(iii)(A) of this section without regard to section 179(d)(2)(A) or (B) or paragraph (b)(3)(v)(A) of this section, and if, as part of the same series of related transactions that includes the acquisition, the transferee member ceases to be a member of the consolidated group within 90 calendar days of the date of the acquisition, then—

(1) The transferor member is treated as disposing of, and the transferee member is treated as acquiring, the depreciable property one day after the date on which the transferee member ceases to be a member of the consolidated group (Deconsolidation Date) for all Federal income tax purposes; and

(2) The transferee member is treated as placing the depreciable property in service not earlier than one day after the Deconsolidation Date for purposes of sections 167 and 168 and §§1.46-3(d) and 1.167(a)-11(e)(1).

(D) *Deemed sales of depreciable property under section 338 or 336(e) to a member that leaves the group.* This paragraph (b)(3)(v)(D) applies only if a member of a consolidated group (transferee member) acquires the stock of another member of the same group that holds depreciable property (target) in either a qualified stock purchase for which a section 338 election is made or a qualified stock disposition described in §1.336-2(b)(1) for which a section 336(e) election is made. Except as otherwise provided in paragraph (b)(3)(v)(E) of this section, if the target would be eligible for the additional first year depreciation deduction under this section with respect to the depreciable property without regard to paragraph (b)(2)(v)(A) of this section, and if the transferee member and the target cease to be members of the group within 90 calendar days of the

acquisition date, within the meaning of §1.338-2(c)(1), or disposition date, within the meaning of §1.336-1(b)(8), as part of the same series of related transactions that includes the acquisition, then—

(1) The acquisition date or disposition date, as applicable, is treated as the date that is one day after the Deconsolidation Date for all Federal income tax purposes; and

(2) New target is treated as placing the depreciable property in service not earlier than one day after the Deconsolidation Date for purposes of sections 167 and 168 and §§1.46-3(d) and 1.167(a)-11(e)(1).

(E) *Disposition of depreciable property pursuant to the same series of related transactions.* Paragraph (b)(3)(v)(C) of this section does not apply if, following the acquisition of depreciable property, the transferee member disposes of such property pursuant to the same series of related transactions that includes the property acquisition. Paragraph (b)(3)(v)(D) of this section does not apply if, following the deemed acquisition of depreciable property, the target disposes of such property pursuant to the same series of related transactions that includes the deemed acquisition. See paragraph (b)(3)(iii)(C) of this section for rules regarding the transfer of property in a series of related transactions. See also paragraph (g)(1) of this section for rules regarding property placed in service and disposed of in the same taxable year.

* * * * *

(vii) * * *

(Y) *Example 25.* (1) On September 5, 2017, Y, a calendar-year taxpayer, acquires and places in service a new machine (Machine #1), and begins using Machine #1 in its manufacturing trade or business. On November 1, 2017, Y sells Machine #1 to Z, then Z leases Machine #1 back to Y for 4 years, and Y continues to use Machine #1 in its manufacturing trade or business. The lease agreement contains a purchase option provision allowing Y to buy Machine #1 at the end of the lease term. On November 1, 2021, Y exercises the purchase option in the lease agreement and buys Machine #1 from Z. The lease between Y and Z for Machine #1 is a true lease for Federal tax purposes.

(2) Because Y, a calendar-year taxpayer, placed in service and disposed of Machine #1 during 2017, Machine #1 is not eligible for the additional first year depreciation deduction for Y pursuant to §1.168(k)-1(g)(1)(i).

(3) The use of Machine #1 by Y prevents Z from satisfying the original use requirement of paragraph (b)(3)(ii) of this section. However, Z's acquisition of Machine #1 satisfies the used property acquisition

requirements of paragraph (b)(3)(iii) of this section. Assuming all other requirements are met, Z's purchase price of Machine #1 qualifies for the additional first year depreciation deduction for Z under this section.

(4) During 2017, Y sold Machine #1 within 90 calendar days of placing in service Machine #1. Pursuant to paragraph (b)(3)(iii)(B)(4) of this section, Y's depreciable interest in Machine #1 during that 90-day period is not taken into account for determining whether Machine #1 was used by Y or a predecessor at any time prior to its reacquisition by Y on November 1, 2021. Accordingly, assuming all other requirements are met, Y's purchase price of Machine #1 on November 1, 2021, qualifies for the additional first year depreciation deduction for Y under this section.

(Z) *Example 26.* Parent owns all of the stock of B and C, which are members of the Parent consolidated group. C has a depreciable interest in Equipment #1. During 2018, C sells Equipment #1 to B. Prior to this acquisition, B never had a depreciable interest in Equipment #1. B's acquisition of Equipment #1 does not satisfy the used property acquisition requirements of paragraph (b)(3)(iii) of this section for two reasons. First, B and C are related parties within the meaning of section 179(d)(2)(B) and §1.179-4(c)(2)(iii). Second, pursuant to paragraph (b)(3)(v)(A) of this section, B is treated as previously having a depreciable interest in Equipment #1 because B is a member of the Parent consolidated group and C, while a member of the Parent consolidated group, had a depreciable interest in Equipment #1. Accordingly, B's acquisition of Equipment #1 is not eligible for the additional first year depreciation deduction.

(AA) *Example 27—(I) Facts.* Parent owns all of the stock of D and E, which are members of the Parent consolidated group. D has a depreciable interest in Equipment #2. No other current or previous member of the Parent consolidated group has ever had a depreciable interest in Equipment #2 while a member of the Parent consolidated group. During 2018, D sells Equipment #2 to BA, a person not related, within the meaning of section 179(d)(2)(A) or (B) and §1.179-4(c), to any member of the Parent consolidated group. In an unrelated transaction during 2019, E acquires Equipment #2 from BA or another person not related to any member of the Parent consolidated group within the meaning of section 179(d)(2)(A) or (B) and §1.179-4(c).

(2) *Analysis.* Pursuant to paragraph (b)(3)(v)(A) of this section, E is treated as previously having a depreciable interest in Equipment #2 because E is a member of the Parent consolidated group and D, while a member of the Parent consolidated group, had a depreciable interest in Equipment #2. As a result, E's acquisition of Equipment #2 does not satisfy the used property acquisition requirements of paragraph (b)(3)(iii) of this section. Thus, E's acquisition of Equipment #2 is not eligible for the additional first year depreciation deduction. The results would be the same if, after selling Equipment #2 to BA, D had ceased to be a member of the Parent consolidated group prior to E's acquisition of Equipment #2.

(BB) *Example 28—(I) Facts.* Parent owns all of the stock of B and S, which are members of the Parent consolidated group. S has a depreciable interest in Equipment #3. No other current or previous

member of the Parent consolidated group has ever had a depreciable interest in Equipment #3 while a member of the Parent consolidated group. X is the common parent of a consolidated group and is not related, within the meaning of section 179(d)(2)(A) or (B) and §1.179-4(c), to any member of the Parent consolidated group. No member of the X consolidated group has ever had a depreciable interest in Equipment #3 while a member of the X consolidated group. On January 1, 2019, B purchases Equipment #3 from S. On February 15, 2019, as part of the same series of related transactions that includes B's purchase of Equipment #3, Parent sells all of the stock of B to X. Thus, B leaves the Parent consolidated group at the end of the day on February 15, 2019, and joins the X consolidated group on February 16, 2019. See §1.1502-76(b).

(2) *Application of paragraph (b)(3)(v)(C) of this section.* B was a member of the Parent consolidated group when B acquired Equipment #3 from S, another member of the same group. Paragraph (b)(3)(v)(A) of this section generally treats each member of a consolidated group as having a depreciable interest in property during the time any member of the group had a depreciable interest in such property while a member of the group. However, B acquired Equipment #3 in a transaction meeting the requirements of paragraph (b)(3)(iii)(A) of this section, without regard to section 179(d)(2)(A) or (B) or paragraph (b)(3)(v)(A) of this section, and Parent sold all of the stock of B to X within 90 calendar days of B's acquisition of Equipment #3 as part of the same series of related transactions that included B's acquisition of Equipment #3. Thus, under paragraph (b)(3)(v)(C) of this section, B's acquisition of Equipment #3 is treated as occurring on February 16, 2019, for all Federal income tax purposes.

(3) *Eligibility for the additional first year depreciation deduction.* B's acquisition of Equipment #3 on February 16, 2019, under paragraph (b)(3)(v)(C) of this section satisfies the requirement in paragraph (b)(3)(iii)(A)(I) of this section because B does not have a prior depreciable interest in Equipment #3. In addition, because no member of the X consolidated group previously had a depreciable interest in Equipment #3 while a member of the X consolidated group, B is not treated as previously having a depreciable interest in Equipment #3 under paragraph (b)(3)(v)(A) of this section. Further, because the relation between S and B is tested as if B acquired Equipment #3 while a member of the X consolidated group, S and B are neither members nor component members of the same controlled group on February 16, 2019. Therefore, section 179(d)(2)(A) and (B) and §1.179-4(c)(1)(ii) and (iii) are satisfied. If the other requirements of paragraph (b)(3)(iii)(A) of this section are satisfied, B is treated as placing Equipment #3 in service on a date not earlier than February 16, 2019, while a member of the X consolidated group. Accordingly, assuming all other requirements of this section are satisfied, B is eligible to claim the additional first year depreciation deduction for Equipment #3 on that date. In addition, because the sale of Equipment #3 is deemed to occur between S, a member of the Parent consolidated group, and B, a member of the X consolidated group, the transaction is not between members of the same consolidated group and thus is not covered by section 168(i)(7)

(B)(ii). Therefore, B's deduction is not limited by section 168(i)(7)(A) when B is treated, under paragraph (b)(3)(v)(C) of this section, as placing Equipment #3 in service on a date not earlier than February 16, 2019.

(CC) *Example 29—(I) Facts.* The facts are the same as *Example 28* in paragraph (b)(3)(viii)(BB)(I) of this section, except that S owns all of the stock of T (rather than a depreciable interest in Equipment #3), which is a member of the Parent consolidated group; T has a depreciable interest in Equipment #3; B acquires all of the stock of T (instead of a depreciable interest in Equipment #3) on January 1, 2019; and S and B make a section 338(h)(10) election for B's qualified stock purchase.

(2) *Application of paragraph (b)(3)(v)(D) of this section.* As a result of the section 338(h)(10) election, Old T is treated as transferring all of its assets, including Equipment #3, to an unrelated person in a single transaction in exchange for consideration at the close of the acquisition date and then transferring the consideration received to S in liquidation. In turn, New T is treated as acquiring all of its assets, including Equipment #3, from an unrelated person in exchange for consideration on the following day. See §1.338-1(a)(1). New T was a member of the Parent consolidated group on January 1, 2019, the date that New T acquired Equipment #3. Paragraph (b)(3)(v)(A) of this section generally treats each member of a consolidated group as having a depreciable interest in property during the time any member of the group had a depreciable interest in such property while a member of the group. However, New T would be eligible for the additional first year depreciation deduction under this section without regard to paragraph (b)(3)(v)(A) of this section, and Parent sold all of its B stock to X within 90 calendar days of New T's acquisition of Equipment #3 as part of the same series of related transactions that included the acquisition, thereby causing B and New T to cease to be members of the Parent consolidated group at the end of the day on February 15, 2019. Thus, paragraph (b)(3)(v)(D) applies to treat the acquisition date as February 16, 2019, for all Federal income tax purposes.

(3) *Eligibility for the additional first year depreciation deduction.* Pursuant to paragraph (b)(3)(v)(D), Old T is treated as selling its assets to an unrelated person on February 16, 2019, and New T is treated as acquiring those assets on the following day, February 17, 2019. If the other requirements of paragraph (b)(3)(iii)(A) of this section are satisfied, New T is treated as placing Equipment #3 in service on a date not earlier than February 17, 2019, while a member of the X consolidated group. Accordingly, assuming all other requirements of this section are satisfied, New T is eligible to claim the additional first year depreciation deduction for Equipment #3 when New T places Equipment #3 in service. In addition, the amount of the deduction is not limited by section 168(i)(7)(A).

(DD) *Example 30—(I) Facts.* G, which is not a member of a consolidated group, has a depreciable interest in Equipment #4. Parent owns all the stock of H, which is a member of the Parent consolidated group. No member of the Parent consolidated group has ever had a depreciable interest in Equipment #4 while a member of the Parent consolidated group, and neither Parent nor H is related to G within the

meaning of section 179(d)(2)(A) or (B) and §1.179-4(c). During 2018, G sells Equipment #4 to a person not related to G, Parent, or H within the meaning of section 179(d)(2)(A) or (B) and §1.179-4(c). In a series of related transactions, during 2019, Parent acquires all of the stock of G, and H purchases Equipment #4 from an unrelated person.

(2) *Analysis.* In a series of related transactions, G became a member of the Parent consolidated group, and H, also a member of the Parent consolidated group, acquired Equipment #4. Because G previously had a depreciable interest in Equipment #4, pursuant to paragraph (b)(3)(v)(B) of this section, H is treated as having a depreciable interest in Equipment #4. As a result, H's acquisition of Equipment #4 does not satisfy the used property acquisition requirements of paragraph (b)(3)(iii) of this section. Accordingly, H's acquisition of Equipment #4 is not eligible for the additional first year depreciation deduction.

(EE) *Example 31. (I)* In a series of related transactions, a father sells a machine to an unrelated individual in December 2019 who sells the machine to the father's daughter in January 2020 for use in the daughter's trade or business. Pursuant to paragraph (b)(3)(iii)(C)(I) of this section, the time to test whether the parties are related is immediately after each step in the series, and between the original transferor and the ultimate transferee immediately after the last transaction in the series. As a result, the following relationships are tested under section 179(d)(2)(A): the father and the unrelated individual, the unrelated individual and the father's daughter, and the father and his daughter.

(2) Because the individual is not related to the father within the meaning of section 179(d)(2)(A) and §1.179-4(c)(ii), the individual's acquisition of the machine satisfies the used property acquisition requirement of paragraph (b)(3)(iii)(A)(2) of this section. Accordingly, assuming all other requirements of this section are satisfied, the individual's purchase price of the machine qualifies for the additional first year depreciation deduction under this section.

(3) The individual and the daughter are not related parties within the meaning of section 179(d)(2)(A) and §1.179-4(c)(ii). However, the father and his daughter are related parties within the meaning of section 179(d)(2)(A) and §1.179-4(c)(ii). Accordingly, the daughter's acquisition of the machine does not satisfy the used property acquisition requirements of paragraph (b)(3)(iii) of this section and is not eligible for the additional first year depreciation deduction.

(FF) *Example 32. (I)* The facts are the same as in *Example 31* of paragraph (b)(3)(viii)(EE)(I) of this section, except that instead of selling to an unrelated individual, the father sells the machine to his son in December 2019 who sells the machine to his sister (the father's daughter) in January 2020. Pursuant to paragraph (b)(3)(iii)(C)(I) of this section, the time to test whether the parties are related is immediately after each step in the series, and between the original transferor and the ultimate transferee immediately after the last transaction in the series. As a result, the following relationships are tested under section 179(d)(2)(A): the father and his son, the father's son and his sister, and the father and the father's daughter.

(2) Because the father and his son are related parties within the meaning of section 179(d)(2)(A)

and §1.179-4(c)(ii), the son's acquisition of the machine does not satisfy the used property acquisition requirements of paragraph (b)(3)(iii) of this section. Accordingly, the son's acquisition of the machine is not eligible for the additional first year depreciation deduction.

(3) The son and his sister are not related parties within the meaning of section 179(d)(2)(A) and §1.179-4(c)(ii). However, the father and his daughter are related parties within the meaning of section 179(d)(2)(A) and §1.179-4(c)(ii). Accordingly, the daughter's acquisition of the machine does not satisfy the used property acquisition requirements of paragraph (b)(3)(iii) of this section and is not eligible for the additional first year depreciation deduction.

(GG) *Example 33.* (1) In June 2018, *DA*, an individual, bought and placed in service a new machine from an unrelated party for use in its trade or business. In a series of related transactions, *DA* sells the machine to *DB* and *DB* places it in service in October 2019, *DB* sells the machine to *DC* and *DC* places it in service in December 2019, and *DC* sells the machine to *DD* and *DD* places it in service in January 2020. *DA* and *DB* are related parties within the meaning of section 179(d)(2)(A) and §1.179-4(c)(ii). *DB* and *DC* are related parties within the meaning of section 179(d)(2)(B) and §1.179-4(c)(iii). *DC* and *DD* are not related parties within the meaning of section 179(d)(2)(A) and §1.179-4(c)(ii), or section 179(d)(2)(B) and §1.179-4(c)(iii). *DA* is not related to *DC* or to *DD* within the meaning of section 179(d)(2)(A) and §1.179-4(c)(ii). All parties are calendar year taxpayers.

(2) *DA*'s purchase of the machine in June 2018 satisfies the original use requirement of paragraph (b)(3)(ii) of this section and, assuming all other requirements of this section are met, qualifies for the additional first year depreciation deduction under this section.

(3) Pursuant to paragraph (b)(3)(iii)(C)(I) of this section, the time to test whether the parties in the series of related transactions are related is immediately after each step in the series, and between the original transferor and the ultimate transferee immediately after the last transaction in the series. However, because *DB* placed in service and disposed of the machine in the same taxable year, *DB* is disregarded pursuant to paragraph (b)(3)(iii)(C)(2)(i) of this section. As a result, the following relationships are tested under section 179(d)(2)(A) and (B): *DA* and *DC*, *DC* and *DD*, and *DA* and *DD*.

(4) Because *DA* is not related to *DC* within the meaning of section 179(d)(2)(A) and §1.179-4(c)(ii), *DC*'s acquisition of the machine satisfies the used property acquisition requirement of paragraph (b)(3)(iii)(A)(2) of this section. Accordingly, assuming all other requirements of this section are satisfied, *DC*'s purchase price of the machine qualifies for the additional first year depreciation deduction under this section.

(5) Because *DC* is not related to *DD* and *DA* is not related to *DD* within the meaning of section 179(d)(2)(A) and §1.179-4(c)(ii), or section 179(d)(2)(B) and §1.179-4(c)(iii), *DD*'s acquisition of the machine satisfies the used property acquisition requirement of paragraph (b)(3)(iii)(A)(2) of this section. Accordingly, assuming all other requirements

of this section are satisfied, *DD*'s purchase price of the machine qualifies for the additional first year depreciation deduction under this section.

(HH) *Example 34.* (1) In June 2018, *EA*, an individual, bought and placed in service a new machine from an unrelated party for use in his trade or business. In a series of related transactions, *EA* sells the machine to *EB* and *EB* places it in service in September 2019, *EB* transfers the machine to *EC* in a transaction described in paragraph (g)(1)(iii) of this section and *EC* places it in service in November 2019, and *EC* sells the machine to *ED* and *ED* places it in service in January 2020. *EA* and *EB* are not related parties within the meaning of section 179(d)(2)(A) and §1.179-4(c)(ii). *EB* and *EC* are related parties within the meaning of section 179(d)(2)(B) and §1.179-4(c)(iii). *EB* and *ED* are related parties within the meaning of section 179(d)(2)(A) and §1.179-4(c)(ii), or section 179(d)(2)(B) and §1.179-4(c)(iii). *EC* and *ED* are not related parties within the meaning of section 179(d)(2)(A) and §1.179-4(c)(ii), or section 179(d)(2)(B) and §1.179-4(c)(iii). *EA* is not related to *EC* or to *ED* within the meaning of section 179(d)(2)(A) and §1.179-4(c)(ii). All parties are calendar year taxpayers.

(2) *EA*'s purchase of the machine in June 2018 satisfies the original use requirement of paragraph (b)(3)(ii) of this section and, assuming all other requirements of this section are met, qualifies for the additional first year depreciation deduction under this section.

(3) Pursuant to paragraph (b)(3)(iii)(C)(I) of this section, the time to test whether the parties in the series of related transactions are related is immediately after each step in the series, and between the original transferor and the ultimate transferee immediately after the last transaction in the series. However, because *EB* placed in service and transferred the machine in the same taxable year in a transaction described in paragraph (g)(1)(iii) of this section, the section 168(i)(7) transaction between *EB* and *EC* is disregarded pursuant to paragraph (b)(3)(iii)(C)(2)(iii) of this section. As a result, the following relationships are tested under section 179(d)(2)(A) and (B): *EA* and *EB*, *EB* and *ED*, *EC* and *ED*, and *EA* and *ED*.

(4) Because *EA* is not related to *EB* within the meaning of section 179(d)(2)(A) and §1.179-4(c)(ii), *EB*'s acquisition of the machine satisfies the used property acquisition requirement of paragraph (b)(3)(iii)(A)(2) of this section. Accordingly, assuming all other requirements of this section are satisfied, *EB*'s purchase price of the machine qualifies for the additional first year depreciation deduction under this section. Pursuant to paragraph (g)(1)(iii) of this section, *EB* is allocated 2/12 of its 100-percent additional first year depreciation deduction for the machine, and *EC* is allocated the remaining portion of *EB*'s 100-percent additional first year depreciation deduction for the machine.

(5) *EC* is not related to *ED* and *EA* is not related to *ED* within the meaning of section 179(d)(2)(A) and §1.179-4(c)(ii), or section 179(d)(2)(B) and §1.179-4(c)(iii). However, *EB* and *ED* are related parties within the meaning of section 179(d)(2)(A) and §1.179-4(c)(ii), or section 179(d)(2)(B) and §1.179-4(c)(iii). Accordingly, *ED*'s acquisition of the machine does not satisfy the used property ac-

quisition requirements of paragraph (b)(3)(iii) of this section and is not eligible for the additional first year depreciation deduction.

* * * * *

(5) * * *

(ii) * * *

(A) * * * For determination of acquisition date, see paragraph (b)(5)(ii)(B) of this section for property acquired pursuant to a written binding contract, paragraph (b)(5)(iv) of this section for self-constructed property, and paragraph (b)(5)(v) of this section for property not acquired pursuant to a written binding contract.

* * * * *

(iii) * * *

(G) *Acquisition of a trade or business or an entity.* A contract to acquire all or substantially all of the assets of a trade or business or to acquire an entity (for example, a corporation, a partnership, or a limited liability company) is binding if it is enforceable under State law against the parties to the contract. The presence of a condition outside the control of the parties, including, for example, regulatory agency approval, will not prevent the contract from being a binding contract. Further, the fact that insubstantial terms remain to be negotiated by the parties to the contract, or that customary conditions remain to be satisfied, does not prevent the contract from being a binding contract. This paragraph (b)(5)(iii)(G) also applies to a contract for the sale of the stock of a corporation that is treated as an asset sale as a result of an election under section 338.

* * * * *

(v) *Determination of acquisition date for property not acquired pursuant to a written binding contract.* Except as provided in paragraphs (b)(5)(iv), (vi), and (vii) of this section, the acquisition date of property that the taxpayer acquires pursuant to a contract that does not meet the definition of a written binding contract in paragraph (b)(5)(ii) of this section, is the date on which the taxpayer paid (in the case of a cash basis taxpayer) or incurred (in the case of an accrual 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 and designing, securing financing, exploring, or researching. This paragraph (b)(5)(v) does not apply to an ac-

quisition described in paragraph (b)(5)(iii) (G) of this section.

* * * * *

(viii) * * * Unless the facts specifically indicate otherwise, assume that the parties are not related within the meaning of section 179(d)(2)(A) or (B) and §1.179-4(c), paragraph (c) of this section does not apply, and the parties do not have predecessors:

* * * * *

(c) *Election for components of larger self-constructed property for which the manufacture, construction, or production begins before September 28, 2017*—(1) *In general*. A taxpayer may elect to treat any acquired or self-constructed component, as described in paragraph (c)(3) of this section, of the larger self-constructed property, as described in paragraph (c) (2) of this section, as being eligible for the additional first year depreciation deduction under this section, assuming all requirements of section 168(k) and this section are met. The taxpayer may make this election for one or more such components.

(2) *Eligible larger self-constructed property*—(i) *In general*. Solely for purposes of this paragraph (c) and except as provided in paragraph (c)(2)(ii) of this section, the larger self-constructed property must be qualified property under section 168(k)(2), as in effect on the day before the date of the enactment of the Act, for which the taxpayer begins the manufacture, construction, or production before September 28, 2017. The determination of when manufacture, construction, or production of the larger self-constructed property begins is made in accordance with the rules in §1.168(k)-1(b)(4)(iii) (B). A larger self-constructed property is property that is manufactured, constructed, or produced by the taxpayer for its own use in its trade or business or for its production of income, or property that is manufactured, constructed, or produced for the taxpayer by another person under a written binding contract, as defined in §1.168(k)-1(b)(4)(ii), 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. If the taxpayer enters into a written binding contract, as defined in paragraph (b)(5)(iii) of this sec-

tion, before September 28, 2017, with another person to manufacture, construct, or produce the larger self-constructed property and the manufacture, construction, or production of this property begins after September 27, 2017, paragraph (b)(5)(iv) of this section applies and paragraph (c) of this section does not apply.

(ii) *Exceptions*. This paragraph (c) does not apply to any larger self-constructed property that meets at least one of the following criteria—

(A) Is placed in service by the taxpayer before September 28, 2017;

(B) Is placed in service by the taxpayer after December 31, 2019, or for property described in section 168(k)(2)(B) or (C) as in effect on the day before the date of the enactment of the Act, after December 31, 2020;

(C) Does not meet the original use requirement in section 168(k)(2)(A)(ii) as in effect on the day before the date of the enactment of the Act;

(D) Is described in section 168(k)(9) and §1.168(k)-2(b)(2)(ii)(F) or (G);

(E) Is described in section 168(g)(1)(F) and (g)(8) (electing real property trade or business) or section 168(g)(1)(G) (electing farming business) and placed in service by the taxpayer in any taxable year beginning after December 31, 2017;

(F) Is qualified leasehold improvement property, as defined in section 168(e)(6) as in effect on the day before amendment by section 13204(a)(1) of the Act, and placed in service by the taxpayer after December 31, 2017;

(G) Is qualified restaurant property, as defined in section 168(e)(7) as in effect on the day before amendment by section 13204(a)(1) of the Act, and placed in service by the taxpayer after December 31, 2017;

(H) Is qualified retail improvement property, as defined in section 168(e)(8) as in effect on the day before amendment by section 13204(a)(1) of the Act, and placed in service by the taxpayer after December 31, 2017;

(I) Is qualified improvement property as defined in §1.168(b)-1(a)(5)(i)(A) (placed in service by the taxpayer after December 31, 2017); or

(J) Is included in a class of property for which the taxpayer made an election under section 168(k)(7) (formerly section 168(k)

(2)(D)(iii)) not to deduct the additional first year depreciation deduction.

(3) *Eligible components*—(i) *In general*. Solely for purposes of this paragraph (c), a component of the larger self-constructed property, as described in paragraph (c)(2) of this section, must be qualified property under section 168(k)(2) and paragraph (b) of this section.

(ii) *Acquired components*. Solely for purposes of this paragraph (c), a binding contract, as defined in paragraph (b)(5) (iii) of this section, to acquire a component of the larger self-constructed property must be entered into by the taxpayer after September 27, 2017.

(iii) *Self-constructed components*. Solely for purposes of this paragraph (c), the manufacture, construction, or production of a component of the larger self-constructed property must begin after September 27, 2017. The determination of when manufacture, construction, or production of the component begins is made in accordance with the rules in paragraph (b)(5)(iv)(B) of this section.

(4) *Special rules*—(i) *Installation costs*. If the taxpayer pays or incurs costs, including labor costs, to install a component of the larger self-constructed property, as described in paragraph (c)(2) of this section, such costs are eligible for additional first year depreciation under this section, assuming all requirements are met, only if the component being installed meets the requirements in paragraph (c) (3) of this section.

(ii) *Property described in section 168(k)(2)(B)*. For purposes of this paragraph (c), the unadjusted depreciable basis, as defined in §1.168(b)-1(a)(3), of qualified property in section 168(k) (2)(B), as in effect on the day before the date of the enactment of the Act, is limited to the property's unadjusted depreciable basis attributable to the property's manufacture, construction, or production before January 1, 2020. The amounts of unadjusted depreciable basis attributable to the property's manufacture, construction, or production before January 1, 2020, are referred to as "progress expenditures." Rules similar to the rules in section 4.02(1)(b) of Notice 2007-36 (2007-17 I.R.B. 1000) (see §601.601(d)(2)(ii) (b) of this chapter) apply for determining progress expenditures.

(5) *Computation of additional first year depreciation deduction—(i) Election is made.* Before determining the allowable additional first year depreciation deduction for property for which the taxpayer makes the election specified in this paragraph (c), the taxpayer must determine the portion of the unadjusted depreciable basis, as defined in §1.168(b)-1(a)(3), of the larger self-constructed property, including all components, attributable to the component that meets the requirements of paragraph (c)(3) of this section (component basis). The additional first year depreciation deduction for the component basis is determined by multiplying such component basis by the applicable percentage for the placed-in-service year of the larger self-constructed property. The additional first year depreciation deduction for the remaining unadjusted depreciable basis of the larger self-constructed property, as described in paragraph (c)(2) of this section, is determined by multiplying such remaining unadjusted depreciable basis by the phase-down percentage in section 168(k)(8) applicable to the placed-in-service year of the larger self-constructed property. For purposes of this paragraph (c), the remaining unadjusted depreciable basis of the larger self-constructed property is equal to the unadjusted depreciable basis, as defined in §1.168(b)-1(a)(3), of the larger self-constructed property, including all components, reduced by the sum of the component basis of the components for which the taxpayer makes the election specified in this paragraph (c). If the phase-down percentage in section 168(k)(8) is zero for the placed-in-service year of the larger self-constructed property, none of the components of the larger self-constructed property qualify for the additional first year depreciation deduction under this section.

(ii) *Election is not made.* If the taxpayer does not make the election specified in this paragraph (c), the additional first year depreciation deduction for the larger self-constructed property, including all components, that is qualified property under section 168(k)(2), as in effect on the day before the date of the enactment of the Act, is determined by multiplying the unadjusted depreciable basis, as defined in §1.168(b)-1(a)(3), of the larger self-constructed property, including all

components, by the phase-down percentage in section 168(k)(8) applicable to the placed-in-service year of the larger self-constructed property.

(6) *Time and manner for making election—(i) Time for making election.* The election specified in this paragraph (c) must be made by the due date, including extensions, of the Federal tax return for the taxable year in which the taxpayer placed in service the larger self-constructed property.

(ii) *Manner of making election.* The election specified in this paragraph (c) must be made by attaching a statement to such return indicating that the taxpayer is making the election provided in this paragraph (c) and whether the taxpayer is making the election for all or some of the components described in paragraph (c)(3) of this section. The election is made separately by each person owning qualified property (for example, for each member of a consolidated group by the common parent of the group, by the partnership (including a lower-tier partnership), or by the S corporation).

(7) *Examples.* The application of this paragraph (c) is illustrated by the following examples. Unless the facts specifically indicate otherwise, assume that the larger self-constructed property is qualified property under section 168(k)(2) as in effect on the day before the date of the enactment of the Act, and the components acquired or self-constructed after September 27, 2017, are qualified property under section 168(k)(2) and paragraph (b) of this section.

(i) *Example 1.* (A) *BC*, a calendar year taxpayer, is engaged in a trade or business described in section 163(j)(7)(A)(iv). In December 2015, *BC* decided to construct an electric generation power plant for its own use. This plant is property described in section 168(k)(2)(B) as in effect on the day before the date of the enactment of the Act. However, the turbine for the plant had to be manufactured by another person for *BC*. In January 2016, *BC* entered into a written binding contract with *CD* to acquire the turbine. *BC* received the completed turbine in August 2017 at which time *BC* incurred the cost of the turbine. The cost of the turbine is 11 percent of the total cost of the electric generation power plant to be constructed by *BC*. *BC* began constructing the electric generation power plant in October 2017 and placed in service this new power plant, including all component parts, in 2020.

(B) *BC* uses the safe harbor test in §1.168(k)-1(b)(4)(iii)(B)(2) to determine when physical work of a significant nature begins for the electric generation power plant. Because the turbine that was man-

factured by *CD* for *BC* is more than 10 percent of the total cost of the electric generation power plant, physical work of a significant nature for this plant began before September 28, 2017. None of *BC*'s expenditures for components of the power plant that are acquired or self-constructed after September 27, 2017, are eligible for the election specified in this paragraph (c) because the power plant is described in section 168(k)(9)(A) and paragraph (b)(2)(ii)(F) of this section and, therefore, are not eligible for the election pursuant to paragraph (c)(2)(ii)(D) of this section. Assuming all requirements are met under section 168(k)(2) as in effect on the day before the date of the enactment of the Act, the unadjusted depreciable basis of the power plant, including all components, attributable to its construction before January 1, 2020, is eligible for the 30-percent additional first year depreciation deduction pursuant to section 168(k)(8).

(ii) *Example 2.* (A) In August 2017, *BD*, a calendar-year taxpayer, entered into a written binding contract with *CE* for *CE* to manufacture a locomotive for *BD* for use in its trade or business. Before September 28, 2017, *BD* incurred \$500,000 of expenses for the locomotive, which is more than 10 percent of the total cost of the locomotive. After September 27, 2017, *BD* incurred \$4,000,000 of expenses for components of the locomotive. These components were acquired or self-constructed after September 27, 2017. In February 2019, *CE* delivered the locomotive to *BD* and *BD* placed in service the locomotive. The total cost of the locomotive is \$4,500,000. The locomotive is property described in section 168(k)(2)(B) as in effect on the day before the date of the enactment of the Act. On its timely filed Federal income tax return for 2019, *BD* made the election specified in this paragraph (c).

(B) *BD* uses the safe harbor test in §1.168(k)-1(b)(4)(iii)(B)(2) to determine when physical work of a significant nature begins for the locomotive. Because *BD* had incurred more than 10 percent of the total cost of the locomotive before September 28, 2017, physical work of a significant nature for this locomotive began before September 28, 2017. Because *BD* made the election specified in this paragraph (c), the cost of \$4,000,000 for the locomotive's components acquired or self-constructed after September 27, 2017, qualifies for the 100-percent additional first year depreciation deduction, assuming all other requirements are met. The remaining cost of the locomotive is \$500,000 and such amount qualifies for the 40-percent additional first year depreciation deduction pursuant to section 168(k)(8).

(iii) *Example 3.* (A) In March 2017, *BE*, a calendar-year taxpayer, decided to construct qualified leasehold improvement property, as defined in section 168(e)(6) as in effect on the day before enactment of the Act, for its own use in its trade or business. This qualified leasehold improvement property also met the definition of qualified improvement property as defined in section 168(k)(3) as in effect on the day before enactment of the Act. Physical work of a significant nature for this qualified leasehold improvement property began before September 28, 2017. After September 27, 2017, *BE* acquired components of the qualified leasehold improvement property at a cost of \$100,000. *BE* placed in service the qualified leasehold improvement property in February 2018.

(B) Because *BE* placed in service the qualified leasehold improvement property after December 31, 2017, none of *BE*'s expenditures of \$100,000 for components of the qualified leasehold improvement property that are acquired after September 27, 2017, are eligible for the election specified in this paragraph (c) pursuant to paragraph (c)(2)(ii)(F) of this section. Additionally, *BE*'s unadjusted depreciable basis of the qualified leasehold improvement property, including all components, is not eligible for any additional first year depreciation deduction under section 168(k) and this section nor under section 168(k) as in effect on the day before enactment of the Act.

* * * * *

(e) * * *

(1) * * *

(iii) * * * The amounts of unadjusted depreciable basis attributable to the property's manufacture, construction, or production before January 1, 2020, are referred to as "progress expenditures." Rules similar to the rules in section 4.02(1)(b) of Notice 2007-36 (2007-17 I.R.B. 1000) (see §601.601(d)(2)(ii)(b) of this chapter) apply for determining progress expenditures.

* * * * *

(g) * * *

(11) *Mid-quarter convention.* In determining whether the mid-quarter convention applies for a taxable year under section 168(d)(3) and §1.168(d)-1, the depreciable basis, as defined in §1.168(d)-1(b)(4), for the taxable year the qualified property is placed in service by the taxpayer is not reduced by the allowed or allowable additional first year depreciation deduction for that taxable year. See §1.168(d)-1(b)(4).

(h) * * *

(4) *Regulation project REG-106808-19—(i) In general.* Except as provided

in paragraph (h)(4)(ii) of this section, the rules of this section in this regulation project REG-106808-19 apply to—

(A) Qualified property under section 168(k)(2) that is placed in service by the taxpayer during or after the taxpayer's taxable year that includes the date of publication of a Treasury decision adopting these rules as final regulations in the **Federal Register**;

(B) A specified plant for which the taxpayer properly made an election to apply section 168(k)(5) and that is planted, or grafted to a plant that was previously planted, after September 27, 2017, by the taxpayer during the taxpayer's taxable year ending on or after September 28, 2017, and ending before the taxpayer's taxable year that includes the date of publication of a Treasury decision adopting these rules as final regulations in the **Federal Register**; and

(C) Components acquired or self-constructed after September 27, 2017, of larger self-constructed property for which manufacture, construction, or production begins before September 28, 2017, and that is qualified property under section 168(k)(2) as in effect before the enactment of the Act and placed in service by the taxpayer during or after the taxpayer's taxable year that includes the date of publication of a Treasury decision adopting these rules as final regulations in the **Federal Register**.

(ii) *Early application of regulation project REG-106808-19.* A taxpayer may rely on the provisions of this section in this regulation project REG-106808-19, in its entirety, for—

(A) Qualified property under section 168(k)(2) acquired and placed in service after September 27, 2017, by the taxpayer during the taxpayer's taxable year

ending on or after September 28, 2017, and ending before the taxpayer's taxable year that includes the date of publication of a Treasury decision adopting these rules as final regulations in the **Federal Register**;

(B) A specified plant for which the taxpayer properly made an election to apply section 168(k)(5) and that is planted, or grafted to a plant that was previously planted, after September 27, 2017, by the taxpayer during the taxpayer's taxable year ending on or after September 28, 2017, and ending before the taxpayer's taxable year that includes the date of publication of a Treasury decision adopting these rules as final regulations in the **Federal Register**; and

(C) Components acquired or self-constructed after September 27, 2017, of larger self-constructed property for which manufacture, construction, or production begins before September 28, 2017, and that is qualified property under section 168(k)(2) as in effect before the enactment of the Act and placed in service by the taxpayer during the taxpayer's taxable year ending on or after September 28, 2017, and ending before the taxpayer's taxable year that includes the date of publication of a Treasury decision adopting these rules as final regulations in the **Federal Register**.

Kirsten Wielobob,
Deputy Commissioner for Services
and Enforcement.

(Filed by the Office of the Federal Register on September 17, 2019, 4:15 p.m., and published in the issue of the Federal Register for September 24, 2019, 84 F.R. 50152)

Definition of Terms

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

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

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

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

Modified is used where the substance of a previously published position is being changed. Thus, if a prior ruling held that a principle applied to A but not to B, and the

new ruling holds that it applies to both A and B, the prior ruling is modified because it corrects a published position. (Compare with *amplified* and *clarified*, above).

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

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

Superseded describes a situation where the new ruling does nothing more than restate the substance and situation of a previously published ruling (or rulings). Thus, the term is used to republish under the 1986 Code and regulations the same position published under the 1939 Code and regulations. The term is also used when it is desired to republish in a single ruling a series of situations, names, etc., that were previously published over a period of time in separate rulings. If the

new ruling does more than restate the substance of a prior ruling, a combination of terms is used. For example, *modified* and *superseded* describes a situation where the substance of a previously published ruling is being changed in part and is continued without change in part and it is desired to restate the valid portion of the previously published ruling in a new ruling that is self contained. In this case, the previously published ruling is first modified and then, as modified, is superseded.

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

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

Abbreviations

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

A—Individual.
Acq.—Acquiescence.
B—Individual.
BE—Beneficiary.
BK—Bank.
B.T.A.—Board of Tax Appeals.
C—Individual.
C.B.—Cumulative Bulletin.
CFR—Code of Federal Regulations.
CI—City.
COOP—Cooperative.
Ct.D.—Court Decision.
CY—County.
D—Decedent.
DC—Dummy Corporation.
DE—Donee.
Del. Order—Delegation Order.
DISC—Domestic International Sales Corporation.
DR—Donor.
E—Estate.
EE—Employee.
E.O.—Executive Order.
ER—Employer.

ERISA—Employee Retirement Income Security Act.
EX—Executor.
F—Fiduciary.
FC—Foreign Country.
FICA—Federal Insurance Contributions Act.
FISC—Foreign International Sales Company.
FPH—Foreign Personal Holding Company.
F.R.—Federal Register.
FUTA—Federal Unemployment Tax Act.
FX—Foreign corporation.
G.C.M.—Chief Counsel’s Memorandum.
GE—Grantee.
GP—General Partner.
GR—Grantor.
IC—Insurance Company.
I.R.B.—Internal Revenue Bulletin.
LE—Lessee.
LP—Limited Partner.
LR—Lessor.
M—Minor.
Nonacq.—Nonacquiescence.
O—Organization.
P—Parent Corporation.
PHC—Personal Holding Company.
PO—Possession of the U.S.
PR—Partner.
PRS—Partnership.

PTE—Prohibited Transaction Exemption.
Pub. L.—Public Law.
REIT—Real Estate Investment Trust.
Rev. Proc.—Revenue Procedure.
Rev. Rul.—Revenue Ruling.
S—Subsidiary.
S.P.R.—Statement of Procedural Rules.
Stat.—Statutes at Large.
T—Target Corporation.
T.C.—Tax Court.
T.D.—Treasury Decision.
TFE—Transferee.
TFR—Transferor.
T.I.R.—Technical Information Release.
TP—Taxpayer.
TR—Trust.
TT—Trustee.
U.S.C.—United States Code.
X—Corporation.
Y—Corporation.
Z—Corporation.

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¹A cumulative list of all revenue rulings, revenue procedures, Treasury decisions, etc., published in Internal Revenue Bulletins 2018–27 through 2018–52 is in Internal Revenue Bulletin 2018–52, dated December 27, 2018.

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Internal Revenue Service

Washington, DC 20224

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INTERNAL REVENUE BULLETIN

The Introduction at the beginning of this issue describes the purpose and content of this publication. The weekly Internal Revenue Bulletins are available at www.irs.gov/irb/.

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