

Liberty Zone. The regulations provide that the term *substantially all* means 80 percent or more.

In addition to the application of the original use rules for qualified property, the regulations provide that used property will satisfy the original use requirement for Liberty Zone property if the used property has not been previously used within the Liberty Zone.

Pursuant to section 1400L(b)(2)(A)(iv), the regulations provide that Liberty Zone property is property that is acquired by the taxpayer by purchase after September 10, 2001, but only if no written binding contract for the acquisition of the property was in effect before September 10, 2001. The term *by purchase* is defined in section 179(d) and § 1.179-4(c). The regulations also provide that the binding contract rules and the disqualified transactions rules for qualified property apply to Liberty Zone property. The self-construction rules for qualified property also apply to self-constructed Liberty Zone property except that the requirement to begin the manufacture, construction, or production of the qualified property before January 1, 2005, does not apply to Liberty Zone property.

Finally, the regulations provide that Liberty Zone property generally must be acquired by a taxpayer after September 10, 2001, and placed in service by the taxpayer before January 1, 2007. However, qualifying nonresidential real property and residential rental property must be acquired by a taxpayer after September 10, 2001, and placed in service by the taxpayer before January 1, 2010.

Computation of Additional First Year Depreciation Deduction and Otherwise Allowable Depreciation

The allowable additional first year depreciation deduction for qualified property or Liberty Zone property is equal to 30 percent of the unadjusted depreciable basis (as defined in § 1.168(k)-1T(a)(2)(iii)) of the property. The allowable additional first year depreciation deduction for 50-percent bonus depreciation property is equal to 50 percent of the unadjusted depreciable basis (as defined in § 1.168(k)-1T(a)(2)(iii)) of the property. For qualified property or 50-percent bonus depreciation property described in section 168(k)(2)(B) (property having a longer production period), the unadjusted depreciable basis (as defined in § 1.168(k)-1T(a)(2)(iii)) of the property is limited to the property's basis attributable to manufacture, construction, or production of the property before January 1, 2005.

The additional first year depreciation deduction is allowed for both regular tax and alternative minimum tax purposes. However, for alternative minimum tax purposes, the amount of the additional first year depreciation deduction is based on the unadjusted depreciable basis of the property for alternative minimum tax purposes. The amount of the additional first year depreciation deduction is not affected by a taxable year of less than 12 months for either regular or alternative minimum tax purposes.

Before determining the amount of depreciation otherwise allowable for qualified property, 50-percent bonus depreciation property, or Liberty Zone property, the taxpayer must first reduce the unadjusted depreciable basis (as defined in § 1.168(k)-1T(a)(2)(iii)) of the property by the amount of the additional first year depreciation deduction allowed or allowable, whichever is greater (the remaining adjusted depreciable basis). Then, the remaining adjusted depreciable basis is depreciated using the applicable depreciation provisions of the Code for the property (that is, section 168 for MACRS property and section 167(f)(1) for computer software). This amount of depreciation is allowed for both regular tax and alternative minimum tax purposes, and is affected by a taxable year of less than 12 months. However, for alternative minimum tax purposes, the amount of depreciation allowed is determined by calculating the remaining adjusted depreciable basis of the property for alternative minimum tax purposes and using the same depreciation method, recovery period, and convention that applies to the property for regular tax purposes. If a taxpayer uses the optional depreciation tables in Rev. Proc. 87-57 (1987-2 C.B. 687) to compute depreciation for qualified property, 50-percent bonus depreciation property, or Liberty Zone property that is MACRS property, the regulations also provide that the remaining adjusted depreciable basis of the property is the basis to which the annual depreciation rates in those tables apply.

Special Rules

The regulations also provide rules for the following situations: (1) Qualified property, 50-percent bonus depreciation property, or Liberty Zone property placed in service and disposed of in the same taxable year; (2) redetermination of basis of qualified property, 50-percent bonus depreciation property, or Liberty Zone 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, 50-percent bonus depreciation property, or Liberty Zone property; (5) like-kind exchanges and involuntary conversions of qualified property, 50-percent bonus depreciation property, or Liberty Zone property; (6) a change in use of qualified property, 50-percent bonus depreciation property, or Liberty Zone property; (7) the computation of earnings and profits; (8) the increase in the limitation of the amount of depreciation for passenger automobiles; and (9) the step-up in basis due to a section 754 election.

With respect to qualified property, 50-percent bonus depreciation property, or Liberty Zone property placed in service and disposed of in the same taxable year, the regulations provide that the additional first year depreciation deduction is not allowed. This rule is consistent with the general rule in § 1.168(d)-1(b)(3)(ii) for MACRS property placed in service and disposed of in the same taxable year. However, as previously discussed, the additional first year depreciation deduction is allowable for qualified property, 50-percent bonus depreciation property, or Liberty Zone property placed in service by a terminated partnership in the same taxable year in which a technical termination of the partnership occurs. In this case, the new partnership, and not the terminated partnership, claims the additional first year depreciation deduction. Similarly, the additional first year depreciation deduction is allowable for qualified property, 50-percent bonus depreciation property, or Liberty Zone property placed in service by a transferor in the same taxable year in which the property is transferred in a step-in-the-shoes transaction described in section 168(i)(7). In this case, the additional first year depreciation deduction for the transferor's taxable year in which the property is placed in service is allocated between the transferor and the transferee on a monthly basis. The allocation shall be made in accordance with the rules in § 1.168(d)-1(b)(7)(ii) for allocating the depreciation deduction between the transferor and the transferee.

The regulations also provide rules for a redetermination of basis of qualified property, 50-percent bonus depreciation property, or Liberty Zone property (for example, due to a contingent purchase price or a discharge of indebtedness). If the unadjusted depreciable basis of the property is redetermined by the date on which the property must be last placed in service to meet the placed-in-service date requirement in section 168(k)(2)(A)(iv), 168(k)(4)(B)(iii), or