

property in a transaction to which section 1033 applies.

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

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

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

(E) *Time of disposition* is when the disposition of the exchanged or involuntarily converted MACRS property or the exchanged or involuntarily converted computer software, as applicable, takes place.

(F) *Time of replacement* is the later of:

- (1) When the property received in the exchange or involuntary conversion is placed in service; or

- (2) The time of disposition of involuntarily converted property.

(G) *Carryover basis* is the lesser of:

- (1) The basis in the acquired MACRS property or acquired computer software, as applicable and as determined under section 1031(d) or 1033(b) and the regulations thereunder; or

- (2) The adjusted depreciable basis of the exchanged or involuntarily converted MACRS property or the exchanged or involuntarily converted computer software, as applicable.

(H) *Excess basis* is any excess of the basis in the acquired MACRS property or acquired computer software, as applicable and as determined under section 1031(d) or 1033(b) and the regulations thereunder, over the carryover basis as determined under paragraph (f)(5)(ii)(G) of this section.

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

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

- (2) Any adjustments to basis provided by other provisions of the Code and the regulations thereunder (including

section 1016(a)(2) and (3)) for periods prior to the disposition of the exchanged or involuntarily converted property.

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

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

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

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

(iii) *Computation—(A) In general.*

Assuming all other requirements are met, the remaining carryover basis for the year of replacement and the remaining excess basis, if any, for the year of replacement for the acquired MACRS property or the acquired computer software, as applicable, are eligible for the additional first year depreciation deduction. The 30-percent additional first year depreciation deduction applies to the remaining carryover basis and the remaining excess basis, if any, of the acquired MACRS property or the acquired computer software if the time of replacement is after September 10, 2001, and before May 6, 2003, or if the taxpayer made the election provided in paragraph (e)(1)(ii)(A) of this section. The 50-percent additional first year depreciation deduction applies to the remaining carryover basis and the remaining excess basis, if any, of the acquired MACRS property or the acquired computer software if the time of replacement is after May 5, 2003, and before January 1, 2005, or before January 1, 2006, for 50-percent bonus depreciation property described in section 168(k)(2)(B). The additional first year depreciation deduction is computed separately for the remaining carryover basis and the remaining excess basis. Rules similar to the rules provided in paragraph (d) of this section apply to property described in section 168(k)(2)(B) and for alternative minimum tax purposes.

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

placed in service and disposed of in an exchange or involuntary conversion in the same taxable year.

(iv) *Sale-leaseback transaction.* For purposes of this paragraph (f)(5), if MACRS property or computer software is sold to a taxpayer and leased back to a person by the taxpayer within three months after the time of disposition of the MACRS property or computer software, as applicable, the time of replacement for this MACRS property or computer software, as applicable, shall not be earlier than the date on which the MACRS property or computer software, as applicable, is used by the lessee under the leaseback.

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

*Example 1.* (i) In December 2002, *EE*, a calendar-year corporation, acquired for \$200,000 and placed in service Canopy V1, a gas station canopy. Canopy V1 is qualified property under section 168(k)(1) and is 5-year property under section 168(e). *EE* depreciated Canopy V1 under the general depreciation system of section 168(a) by using the 200-percent declining balance method of depreciation, a 5-year recovery period, and the half-year convention. *EE* elected to use the optional depreciation tables to compute the depreciation allowance for Canopy V1. On January 1, 2003, Canopy V1 was destroyed in a fire and was no longer usable in *EE*'s business. On June 1, 2003, in a transaction described in section 1033(a)(2), *EE* acquired and placed in service Canopy W1 with all of the \$160,000 of insurance proceeds *EE* received due to the loss of Canopy V1. Canopy W1 is 50-percent bonus depreciation property under section 168(k)(4) and is 5-year property under section 168(e).

(ii) For 2002, *EE* is allowed a 30-percent additional first year depreciation deduction of \$60,000 for Canopy V1 (the unadjusted depreciable basis of \$200,000 multiplied by .30), and a regular MACRS depreciation deduction of \$28,000 for Canopy V1 (the remaining adjusted depreciable basis of \$140,000 multiplied by the annual depreciation rate of .20 for recovery year 1).

(iii) Pursuant to paragraph (f)(5)(iii)(A) of this section, the additional first year depreciation deduction allowable for Canopy W1 equals \$56,000 (.50 of Canopy W1's remaining carryover basis of \$112,000 (Canopy V1's remaining adjusted depreciable basis of \$140,000 minus 2002 regular MACRS depreciation deduction of \$28,000)).

*Example 2.* (i) Same facts as in Example 1, except *EE* elected not to deduct the additional first year depreciation for 5-year property placed in service in 2002. *EE* deducted the additional first year depreciation for 5-year property placed in service in 2003.

(ii) For 2002, *EE* is allowed a regular MACRS depreciation deduction of \$40,000 for Canopy V1 (the unadjusted depreciable basis of \$200,000 multiplied by the annual depreciation rate of .20 for recovery year 1).

(iii) Pursuant to paragraph (f)(5)(iii)(A) of this section, the additional first year