

26 CFR 601.105: Examination of returns and claims for refund, credit or abatement; determination of correct tax liability.

(Also Part I, §§ 168, 446, 1400L; 1.168(k)-1T, 301.9100-2, 301.9100-3.)

Rev. Proc. 2005-43

SECTION 1. PURPOSE

This revenue procedure provides procedures by which a taxpayer may elect not to treat qualified New York Liberty Zone (Liberty Zone) leasehold improvement property as 5-year property for purposes of § 168 of the Internal Revenue Code.

This revenue procedure also modifies section 2.01 of the APPENDIX of Rev. Proc. 2002-9, 2002-1 C.B. 327 (as modified by Rev. Proc. 2004-11, 2004-1 C.B. 311, modified and clarified by Announcement 2002-17, 2002-1 C.B. 561, modified and amplified by Rev. Proc. 2002-19, 2002-1 C.B. 696, and amplified, clarified, and modified by Rev. Proc. 2002-54, 2002-2 C.B. 432), to conform with the election not to treat qualified Liberty Zone

leasehold improvement property as 5-year property. Also, because personal property is not eligible for the rehabilitation credit under § 47, section 2.01 of the Appendix of Rev. Proc. 2002-9 is modified to exclude a change in depreciation involving property for which the rehabilitation credit was claimed and that a taxpayer is reclassifying generally to personal property.

SECTION 2. BACKGROUND

.01 Section 1400L(c), as added by § 301(a) of the Job Creation and Worker Assistance Act of 2002 (the “JCWAA”), Pub. L. No. 107-147, 116 Stat. 21 (March 9, 2002), provides that, for purposes of § 168, 5-year property includes any qualified Liberty Zone leasehold improvement property. For purposes of § 1400L, § 1400L(c)(2) provides that qualified Liberty Zone leasehold improvement property means qualified leasehold improvement property (as defined in § 168(k)(3) and § 1.168(k)-1T(c) of the temporary Income Tax Regulations) if (A) the building is located in the New York Liberty Zone (as defined in § 1400L(h)), (B) the improve-

ment is placed in service after September 10, 2001, and before January 1, 2007, and (C) no written binding contract for the improvement was in effect before September 11, 2001. Section 1400L(c)(3) provides that the applicable depreciation method under § 168 is the straight-line method of depreciation for qualified Liberty Zone leasehold improvement property. Section 1400L(c)(4) provides that for purposes of the alternative depreciation system of § 168(g), the class life for qualified Liberty Zone leasehold improvement property is 9 years.

.02 Section 403(c)(3) of the Working Families Tax Relief Act of 2004 (the “WFTRA”), Pub. L. No. 108-311, 118 Stat. 1166 (October 4, 2004), amended § 1400L(c) by adding § 1400L(c)(5), which allows a taxpayer to elect not to treat qualified Liberty Zone leasehold improvement property placed in service by the taxpayer during the taxable year as 5-year property for purposes of § 168. The rules to make this election are similar to the rules of § 168(k)(2)(D)(iii) (as redesignated by § 336(a)(1) of the American Jobs Creation Act of 2004 (the “AJCA”),

Pub. L. No. 108-357, 118 Stat. 1480 (October 22, 2004)) and § 1.168(k)-1T(e) with respect to the election not to deduct the additional first year depreciation. This amendment is effective as if included in the provisions of the JCWAA.

.03 Section 211 of the AJCA amended § 168(e)(3) by providing that 15-year property includes any qualified leasehold improvement property placed in service after October 22, 2004, and before January 1, 2006. As a result, qualified leasehold improvement property is depreciated over a 15-year recovery period for purposes of the general depreciation system of § 168(a). Section 211 of the AJCA also amended § 168(b) to require the straight-line method of depreciation for any qualified leasehold improvement property and amended § 168(g) to require a 39-year recovery period for any qualified leasehold improvement property for purposes of the alternative depreciation system of § 168(g). For purposes of § 168(e), the term “qualified leasehold improvement property” is defined in § 168(e)(6) (as added by § 211 of the AJCA) as having the same meaning given that term in § 168(k)(3) and § 1.168(k)-1T(c) except that if the improvement was made by the person who was the lessor of the improvement when the improvement was placed in service, the improvement generally will be qualified leasehold improvement property only so long as the improvement is held by that person.

.04 If qualified Liberty Zone leasehold improvement property is not qualified leasehold improvement property (as defined in § 168(e)(6)), a taxpayer may elect not to treat qualified Liberty Zone leasehold improvement property placed in service by the taxpayer during the taxable year as 5-year property under § 168 and instead depreciate this property under § 168 as nonresidential real property over a 39-year recovery period for purposes of the general depreciation system of § 168(a) or over a 40-year recovery period for purposes of the alternative depreciation system of § 168(g). If qualified Liberty Zone leasehold improvement property is qualified leasehold improvement property (as defined in § 168(e)(6)), a taxpayer may elect not to treat qualified Liberty Zone leasehold improvement property placed in service by the taxpayer during the taxable year as 5-year property under § 168

and instead depreciate this property under § 168 over a 15-year recovery period for purposes of the general depreciation system of § 168(a) or over a 39-year recovery period for purposes of the alternative depreciation system of § 168(g). In all cases, the qualified Liberty Zone leasehold improvement property is depreciated under § 168 by using the straight-line method of depreciation and is not eligible for the additional first year depreciation deduction provided by § 168(k) or § 1400L(b).

SECTION 3. ELECTION NOT TO TREAT QUALIFIED LIBERTY ZONE LEASEHOLD IMPROVEMENT PROPERTY AS 5-YEAR PROPERTY

.01 *In General.* Pursuant to § 1400L(c)(5), a taxpayer may elect not to treat qualified Liberty Zone leasehold improvement property placed in service by the taxpayer during the taxable year as 5-year property under § 168. If the taxpayer makes this election, it applies to all qualified Liberty Zone leasehold improvement property placed in service by the taxpayer during the same taxable year.

.02 *Time and Manner of Making the Election.*

(1) *In general.* Except as provided in section 4 of this revenue procedure, an election not to treat as 5-year property the qualified Liberty Zone leasehold improvement property placed in service by a taxpayer during the taxable year must be made by the due date (including extensions) of the federal tax return for the taxable year in which the qualified Liberty Zone leasehold improvement property is placed in service by the taxpayer. The election must be made in the manner prescribed on Form 4562, *Depreciation and Amortization*, and its instructions. For example, the instructions for the 2004 Form 4562 require the taxpayer to attach to the federal tax return a statement indicating that the taxpayer is making the election under § 1400L(c)(5). The election is made separately by each person owning qualified Liberty Zone leasehold improvement property (for example, the common parent makes the election for each member of a consolidated group that wants to make the election; by the partnership; or by the S corporation). If a taxpayer files a 2003 or 2004 federal tax return after June 29, 2005, the taxpayer must follow the procedures

in this section 3.02 (including the manner prescribed by the instructions for the 2004 Form 4562) for making the election not to treat as 5-year property the qualified Liberty Zone leasehold improvement property placed in service by the taxpayer after September 10, 2001, during the 2003 or 2004 taxable year.

(2) *Limited relief for late election.*

(a) *Automatic 6-month extension.* An automatic extension of 6 months from the due date of the federal tax return (*excluding* extensions) for the placed-in-service year of the qualified Liberty Zone leasehold improvement property is granted to make the election not to treat as 5-year property the qualified Liberty Zone leasehold improvement property placed in service by a taxpayer during the taxable year, provided the taxpayer filed the taxpayer’s federal tax return for the placed-in-service year and the taxpayer satisfies the requirements in § 301.9100-2(c) and § 301.9100-2(d) of the Procedure and Administration Regulations. *See* § 301.9100-2(b).

(b) *Other extensions.* A taxpayer that fails to make the election not to treat as 5-year property the qualified Liberty Zone leasehold improvement property placed in service by the taxpayer during the taxable year as provided in section 3.02(1), 3.02(2)(a), or 4 of this revenue procedure but wants to do so must file a request for an extension of time to make the election under the rules in § 301.9100-3.

.03 *Revocation.* An election not to treat as 5-year property the qualified Liberty Zone leasehold improvement property placed in service during the taxable year is revocable only with the prior written consent of the Commissioner of Internal Revenue. To seek the Commissioner’s consent, the taxpayer must submit a request for a letter ruling in accordance with the provisions of Rev. Proc. 2005-1, 2005-1 I.R.B. 1 (or any successor).

.04 *Failure to make election not to treat as 5-year property qualified Liberty Zone leasehold improvement property.* Except as provided in section 4 of this revenue procedure, the election not to treat qualified Liberty Zone leasehold improvement property as 5-year property cannot be made in any other manner (for example, through a request under § 446(e) to change the taxpayer’s method of accounting). Thus, if a taxpayer fails to

make the election not to treat as 5-year property qualified Liberty Zone leasehold improvement property within the time and in the manner prescribed in section 3.02 or 4 of this revenue procedure, the amount of depreciation allowable for that property under § 168 must be determined for the placed-in-service year and for all subsequent taxable years by using the straight-line method of depreciation and, as applicable, a 5-year recovery period for purposes of the general depreciation system of § 168(a) or a 9-year recovery period for purposes of the alternative depreciation system of § 168(g).

SECTION 4. ELECTION PROCEDURES FOR RETURNS FILED ON OR BEFORE JUNE 29, 2005

.01 *In general.* If a taxpayer filed its 2000, 2001, 2002, 2003, or 2004 federal tax return on or before June 29, 2005, and used a 5-year recovery period or a 9-year recovery period, as applicable, to depreciate qualified Liberty Zone leasehold improvement property placed in service by the taxpayer after September 10, 2001, during the 2000, 2001, 2002, 2003, or 2004 taxable year, but wants to depreciate this property using a 39-year recovery period or 40-year recovery period, as applicable (or using a 15-year recovery period or 39-year recovery period, as applicable, if the qualified Liberty Zone leasehold improvement property is qualified leasehold improvement property under § 168(e)(6)), the taxpayer may elect not to use the 5-year recovery period or 9-year recovery period, as applicable, for the qualified Liberty Zone leasehold improvement property either by:

(1) filing an amended federal tax return(s) (or a qualified amended return(s) under Rev. Proc. 94-69, 1994-2 C.B. 804, if applicable) on or before June 29, 2007, for the placed-in-service year and all subsequent affected taxable year(s), provided that the placed-in-service year and all subsequent affected taxable year(s) are open under the period of limitations for assessment under § 6501(a). The amended return(s) (or qualified amended return(s)) should include the statement “Filed Pursuant to Rev. Proc. 2005-43” at the top of the amended return(s) (or qualified amended return(s)); or

(2) filing a Form 3115, *Application for Change in Accounting Method*, with the taxpayer’s federal tax return for the taxable year that includes June 29, 2005, or with the taxpayer’s federal tax return for the first taxable year succeeding the taxable year that included June 29, 2005. This Form 3115 must be filed in accordance with the automatic change in method of accounting provisions in Rev. Proc. 2002-9 or any successor, with the following modifications:

(a) The scope limitations in section 4.02 of Rev. Proc. 2002-9 do not apply; and

(b) For purposes of section 6.02(4)(a) of Rev. Proc. 2002-9, the taxpayer should include on line 1a of the Form 3115 (revised December 2003) the designated automatic accounting method change number for the change in method of accounting for depreciation made under this section 4. This number for this method change is “93.”

.02 *Deemed election.* A taxpayer also will be treated as making the election not to use the 5-year recovery period or 9-year recovery period, as applicable, to depreciate qualified Liberty Zone leasehold improvement property placed in service by the taxpayer after September 10, 2001, during the 2000, 2001, 2002, 2003, or 2004 taxable year, if the taxpayer on the return filed for that taxable year, depreciated all qualified Liberty Zone leasehold improvement property placed-in-service by the taxpayer after September 10, 2001, during the 2000, 2001, 2002, 2003, or 2004 taxable year, as applicable, under § 168 by using the straight-line method of depreciation and, as applicable, a 39-year recovery period for purposes of the general depreciation system of § 168(a) or a 40-year recovery period for purposes of the alternative depreciation system of § 168(g) (or, as applicable, a 15-year recovery period for purposes of § 168(a) or a 39-year recovery period for purposes of § 168(g) if the qualified Liberty Zone leasehold improvement property is qualified leasehold improvement property under § 168(e)(6)).

SECTION 5. EFFECT ON OTHER DOCUMENTS

.01 Rev. Proc. 2002-9 is modified and amplified to include the accounting method change provided in section 4.01 of this revenue procedure in section 2 of the APPENDIX.

.02 Section 2.01 of the APPENDIX of Rev. Proc. 2002-9, as modified by Rev. Proc. 2004-11, 2004-1 C.B. 311, is modified as follows:

(1) Section 2.01(1)(d)(xii) of the APPENDIX is modified to read as follows:

“(xii) any change in method of accounting involving both a change from treating the cost or other basis of the property as nondepreciable or nonamortizable property to treating the cost or other basis of the property as depreciable or amortizable property and the adoption of a method of accounting for depreciation requiring an election under § 167, § 168, § 1400I, § 1400L, former § 168, or § 13261(g)(2) or (3) of the 1993 Act (for example, a change in the treatment of the space consumed in landfills placed in service in 1990 from nondepreciable to depreciable property (assuming section 2.01(1)(d)(xiii) of the APPENDIX does not apply) and the making of an election under 168(f)(1) to depreciate this property under the unit-of-production method of depreciation under § 167);”

(2) Section 2.01(1)(d)(xiv) and (xv) of the APPENDIX are modified, and section 2.01(1)(d)(xvi) of the APPENDIX is added, to read as follows:

“(xiv) a change from determining depreciation under § 168 to determining depreciation under former § 168 for any property subject to the transition rules in § 203(b) or 204(a) of the Tax Reform Act of 1986, 1986-3 (Vol. 1) C.B. 1, 60-80;

(xv) any change in the placed-in-service date of a depreciable or amortizable property. This change is corrected by adjustments in the applicable taxable year provided under § 1.446-1T(e)(2)(ii)(d)(3)(v); or

(xvi) any property for which the rehabilitation credit under § 47 was claimed and that a taxpayer is reclassifying to 3-year property, 5-year property, 7-year property, 10-year property (other than real property with a class life of more than 12.5 years), 15-year property (other than real property with a class life of more than 12.5 years), 20-year property (other than real property with a class life of more than 12.5 years), or water utility property (other than real property with a class life of more than 12.5 years).”

(3) Section 2.01(5)(i) of the APPENDIX is modified as follows:

“(i) *Qualified New York Liberty Zone leasehold improvement property.* The depreciation allowable for any taxable year for qualified New York Liberty Zone leasehold improvement property (as defined in § 1400L(c)(2)) is determined by using the depreciation method and recovery period prescribed in § 1400L(c) unless the taxpayer made a timely valid election under § 1400L(c)(5) not to use that recovery period.”

SECTION 6. EFFECTIVE DATE

This revenue procedure is effective for qualified Liberty Zone leasehold improvement property placed in service after September 10, 2001. With respect to the new section 2.01(1)(d)(xvi) of the APPENDIX of Rev. Proc. 2002–9, this revenue procedure is effective for a Form 3115 filed for taxable years ending after July 31, 2005.

DRAFTING INFORMATION

The principal author of this revenue procedure is Douglas Kim of the Office of Associate Chief Counsel (Passthroughs and Special Industries). For further information regarding this revenue procedure, contact Mr. Kim at (202) 622–3110 (not a toll-free call).