

Part III – Administrative, Procedural, and Miscellaneous

Interim Guidance on Special Depreciation Allowance for Qualified Production Property

Notice 2026-16

SECTION 1. PURPOSE

This notice announces that the Department of the Treasury (Treasury Department) and the Internal Revenue Service (IRS) intend to issue proposed regulations (forthcoming proposed regulations) addressing the special depreciation allowance for qualified production property under § 168(n) of the Internal Revenue Code (Code),¹ as added by § 70307 of Public Law 119-21, 139 Stat. 72 (July 4, 2025), commonly known as the One, Big, Beautiful Bill Act (OBBBA). The Treasury Department and IRS expect the forthcoming proposed regulations to be consistent with the interim guidance provided in sections 3 through 8 of this notice. Section 3 of this notice provides general definitions for purposes of the notice. Section 4 of this notice addresses the definition of qualified production property. Section 5 of this notice addresses the definition of qualified production activity and other related terms. Section 6 of this notice addresses special rules. Section 7 of this notice addresses the time and manner for making an election to designate property as qualified production property. Section 8 of this notice addresses depreciation recapture due to a change in use of qualified production

¹ Unless otherwise specified, all “section” or “§” references are to sections of the Code or the Income Tax Regulations (26 CFR part 1).

property. Section 9 of this notice addresses the expected applicability date of the forthcoming proposed regulations and the ability of taxpayers to rely on the guidance in this notice.

SECTION 2. BACKGROUND

.01 In general. Section 167(a) allows as a deduction a reasonable allowance for the exhaustion, wear and tear, and obsolescence of property used in a trade or business or of property held for the production of income (depreciation deduction). The depreciation deduction allowable for tangible depreciable property placed in service after 1986 generally is determined under the Modified Accelerated Cost Recovery System (MACRS) provided by § 168.

Section 70307 of the OBBBA amended § 168 to add § 168(n) to provide a temporary special depreciation allowance for qualified production property placed in service after July 4, 2025. Section 168(n)(1)(A) provides that, for any qualified production property for which an election is made, the depreciation deduction provided by § 167(a) for the taxable year such property is placed in service includes an allowance equal to 100 percent of the adjusted basis of the qualified production property. Section 168(n)(1)(B) provides that the adjusted basis of the qualified production property is reduced by the amount of the deduction under § 168(n)(1)(A) before computing the amount otherwise allowable as a depreciation deduction for such taxable year and any subsequent taxable year.

.02 Definition of qualified production property.

(1) In general. Section 168(n)(2)(A) defines the term qualified production property as that portion of any nonresidential real property:

(a) to which § 168 applies,

(b) that is used by the taxpayer as an integral part of a qualified production activity (as defined in § 168(n)(2)(D)),

(c) that is placed in service in the United States or any territory of the United States,

(d) the original use of which commences with the taxpayer,

(e) the construction of which begins after January 19, 2025, and before January 1, 2029,

(f) that is designated by the taxpayer in an election under § 168(n), and

(g) that is placed in service after July 4, 2025, and before January 1, 2031.

(2) Leased property. Under § 168(n)(2)(A), for purposes of determining whether property is used by the taxpayer as an integral part of a qualified production activity, in the case of property with respect to which the taxpayer is a lessor, property used by a lessee is not considered to be used by the taxpayer as part of a qualified production activity.

(3) Special rule for certain property not previously used in qualified production activities.

(a) In general. Section 168(n)(2)(B) provides special rules for determining whether certain used property may be qualified production property. Under § 168(n)(2)(B)(i), a taxpayer that acquires used property after January 19, 2025, and before January 1, 2029, is treated as the original user of the property and the construction of the property is treated as having begun after January 19, 2025, and before January 1, 2029, if:

(i) the property was not used in a qualified production activity (determined without regard to whether such activity resulted in a substantial transformation of the property comprising the qualified product) by any person at any time during the period beginning on January 1, 2021, and ending on May 12, 2025,

(ii) the property was not used by the taxpayer at any time prior to such acquisition, and

(iii) the acquisition of the property meets the requirements of § 179(d)(2) and (3) (that is, the property is not acquired from a related party or by a member of a controlled group from another member of the same group, and the taxpayer's basis in the property is not determined by reference to its basis in the hands of the transferor).

(b) When property is acquired. Section 168(n)(2)(B)(ii)(I) provides that, for purposes of determining whether used property is acquired before the period that begins after January 19, 2025, and ends before January 1, 2029, the property is treated as acquired not later than the date on which the taxpayer enters into a written binding contract for such acquisition. Section 168(n)(2)(B)(ii)(II) provides that used property is treated as acquired not earlier than such date for purposes of determining whether it is acquired after such period.

(4) Exclusion of office space, etc. Section 168(n)(2)(C) provides that qualified production property does not include any portion of nonresidential real property that is used for offices, administrative services, lodging, parking, sales activities, research activities, software development or engineering activities, or other functions unrelated to the manufacturing, production, or refining of tangible personal property.

(5) Definition of qualified production activity. Section 168(n)(2)(D) defines qualified

production activity as the manufacturing, production, or refining of a qualified product that results in a substantial transformation of the property comprising the qualified product.

(6) Definition of production. Section 168(n)(2)(E) provides that production does not include activities other than agricultural and chemical production.

(7) Definition of qualified product. Section 168(n)(2)(F) defines a qualified product as any tangible personal property, other than a food or beverage prepared in the same building as a retail establishment in which it is sold.

(8) Other rules.

(a) Syndication. Section 168(n)(2)(G) provides that, for purposes of § 168(n)(2)(A)(iv), which requires that property must be originally used by a taxpayer to be qualified production property in that taxpayer's hands, rules similar to § 168(k)(2)(E)(iii) apply.

(b) Extension of time for satisfying placed-in-service-date requirement under certain circumstances. Under § 168(n)(2)(H), in the case of a taxpayer prevented from placing in service property that would otherwise be qualified production property before January 1, 2031, the Secretary of the Treasury Department or the Secretary's delegate (Secretary) may extend the time for satisfying the placed-in-service-date requirement if the Secretary determines that such taxpayer was prevented from placing the property in service before January 1, 2031, due to an act of God (as defined in the Comprehensive Environmental Response, Compensation, and Liability Act of 1980, § 101(1), 42 U.S.C. 9601).

(c) Alternative minimum tax. Section 168(n)(3) provides that, in determining

alternative minimum taxable income under § 55, the deduction under § 167 for qualified production property is determined under § 168 without regard to any adjustment under § 56.

.03 Coordination with certain other provisions.

(1) Other special depreciation allowances. Section 168(n)(4)(A) provides that, for purposes of § 168(k)(7) (election out of the special depreciation allowance for qualified property), § 168(l)(3)(D) (election out of the special depreciation allowance for qualified second generation biofuel plant property), and § 168(m)(2)(B)(iii) (election out of the special depreciation allowance for qualified reuse and recycling property), qualified production property is treated as a separate class of property, and the taxpayer is treated as having made an election under such subsections with respect to such class if the taxpayer elects to treat the property as qualified production property under § 168(n).

(2) Alternative depreciation property. Section 168(n)(4)(B) provides that qualified production property does not include any property to which the alternative depreciation system (ADS) under § 168(g) applies. For purposes of the election to use ADS under § 168(g)(7)(A), qualified production property is treated as separate nonresidential real property.

.04 Recapture. Section 168(n)(5)(A) provides that if, at any time during the 10-year period beginning on the date that qualified production property is placed in service by the taxpayer, the property ceases to be used as an integral part of a qualified production activity and is used in another productive use, § 1245 is applied by (1) treating the property as having been disposed of when first used in a productive use that is not a qualified production activity, and (2) treating as ordinary income the excess of the

property's recomputed basis, as defined in § 1245(a)(2), over its adjusted basis. In addition, § 168(n)(5)(B) provides that the taxpayer's basis in the property and allowance for depreciation with respect to such property is appropriately adjusted to take into account the ordinary income recognized by reason of § 168(n)(5)(A).

.05 Election to apply § 168(n). Section 168(n)(6)(A) provides that an election under § 168(n)(6) for any taxable year (1) must specify the nonresidential real property subject to the election and the portion of such property designated as qualified production property under § 168(n)(2)(A)(vi), and (2) except as otherwise provided by the Secretary, is made on the taxpayer's Federal income tax return for the taxable year. Further, such election is made in such manner as the Secretary may prescribe by regulations or other guidance. Section 168(n)(6)(B) provides that any election made under § 168(n)(6), and any specification contained in any such election, may not be revoked except with the consent of the Secretary (and the Secretary may provide such consent only in extraordinary circumstances).

.06 Authority to prescribe regulations and other guidance. Section 168(n)(7) directs the Secretary to issue regulations or other guidance as may be necessary or appropriate to carry out the purposes of § 168(n), including regulations or other guidance providing rules (1) for what constitutes substantial transformation of property that are consistent with guidance provided under § 954(d), and (2) for the application of the depreciation recapture rule in § 168(n)(5) with respect to a change in use by a transferee following a fully or partially tax-free transfer of qualified production property.

SECTION 3. GENERAL DEFINITIONS

For purposes of this notice, the following general definitions apply, but see section

5.02 of this notice for definitions specifically applicable to defining a qualified production activity:

.01 Property. The term property means a single unit of property, as determined under section 4.03 of this notice.

.02 Eligible property. The term eligible property refers to property, or the collective portions thereof, meeting the requirements in section 4.01 of this notice (other than the requirement in section 4.01(6) of this notice).

.03 Ineligible property. The term ineligible property refers to any property, or any portion thereof, that is not eligible property.

.04 Building. The term building has the same meaning as in § 1.48-1(e)(1).

.05 Structural components. The term structural components has the same meaning as in § 1.48-1(e)(2).

.06 MACRS property. The term MACRS property has the same meaning as in § 1.168(b)-1(a)(2).

.07 Placed in service. The term placed in service has the same meaning as the term “first placed in service” in § 1.167(a)-11(e)(1).

.08 United States. The term United States has the same meaning as in § 7701(a)(9).

.09 Territory of the United States. The term territory of the United States means one of the following territories of the United States: American Samoa, Guam, the Northern Mariana Islands, the Virgin Islands, and the Commonwealth of Puerto Rico (see § 7701(d)).

.10 Unadjusted depreciable basis. The term unadjusted depreciable basis has the

same meaning as in § 1.168(b)-1(a)(3).

SECTION 4. QUALIFIED PRODUCTION PROPERTY

.01 In general. Except as otherwise provided in section 4.06 of this notice, the term qualified production property (QPP) means property, or a portion thereof, that is nonresidential real property and—

(1) That is MACRS property;

(2) That is used by the taxpayer, or will be used by the taxpayer once placed in service, as an integral part of a qualified production activity (QPA), as defined in section 5 of this notice (integral part requirement);

(3) That is placed in service in the United States or any territory of the United States;

(4) The original use of which commences with the taxpayer (original use requirement);

(5) The construction of which begins after January 19, 2025, and before January 1, 2029, as determined under section 4.05 of this notice (beginning of construction requirement);

(6) That the taxpayer designates as QPP under section 4.09 of this notice in an election made in the time and manner provided in section 7 of this notice;

(7) That is placed in service after July 4, 2025, and before January 1, 2031 (placed-in-service-date requirement);

(8) That is not property to which the alternative depreciation system (ADS) under § 168(g) applies; and

(9) That is not ineligible property described in section 4.07 of this notice.

.02 Integral part requirement.

(1) In general. Property, or a portion thereof, is used as an integral part of a QPA and satisfies the integral part requirement if a QPA is conducted in, or takes place within, the physical space of such property or within a portion of the physical space thereof. If a QPA is conducted in, or takes place within, only a portion of the physical space of a property, only such portion satisfies the integral part requirement. Each unit of property, as determined under section 4.03(1) of this notice, must satisfy the integral part requirement on its own; however, see section 4.03(2) for a special rule for integrated facilities.

(2) De minimis rule. If 95 percent or more of the physical space of a property satisfies the integral part requirement at the time the property is placed in service, the taxpayer may elect to treat the entire property as satisfying the integral part requirement. Such election is made by including a declaration in the taxpayer's election statement under section 7 of this notice.

(3) Property used by a lessee.

(a) In general. Except as provided in section 4.02(3)(b) and (c) of this notice, in the case of property with respect to which the taxpayer is a lessor, property used by a lessee engaged in a QPA is not treated as used by the taxpayer as an integral part of a QPA and the taxpayer does not satisfy the integral part requirement. See § 168(n)(2)(A).

(b) Exception for consolidated groups. If a member (S) of a consolidated group (each as defined in § 1.1502-1) owns and leases property to another member (B) of the group (intercompany lease), then for purposes of section 4.02(3)(a) of this notice, S is

not treated as a lessor with respect to the property, and for purposes of section 4.02(1) of this notice, the consolidated group is treated as a single taxpayer. Accordingly, S determines whether the leased property subject to the intercompany lease with B satisfies the integral part requirement by reference to the trade or business activities of B conducted in, or taking place within, the leased property.

(c) Exception for commonly controlled pass-through entities. If a partnership or an S corporation, referred to as a lessor pass-through entity in this notice, or an individual leases property to a commonly controlled person, then for purposes of section 4.02(3)(a) of this notice, the lessor pass-through entity or lessor individual is not treated as a lessor with respect to the property, and for purposes of section 4.02(1) of this notice, the lessor pass-through entity or lessor individual determines whether the property meets the integral part requirement by reference to the commonly controlled person's trade or business activities conducted in, or taking place within, the leased property. The term commonly controlled person means either:

(i) a sole proprietorship, partnership, or corporation of which 50 percent or more is owned, directly or by attribution under § 267(b) or § 707(b), by the same person or group of persons that own, directly or by attribution under § 267(b) or § 707(b), 50 percent or more of the lessor pass-through entity for a majority of the taxable year in which the property is placed in service, including on the last day of such year, or

(ii) a sole proprietorship, partnership, or corporation of which 50 percent or more is owned, directly or by attribution under § 267(b) or § 707(b), by the lessor individual or the lessor pass-through entity for a majority of the taxable year in which the property is placed in service, including on the last day of such year.

.03 Unit-of-property determination.

(1) In general. Except as provided in section 4.03(2) of this notice, the term unit of property means the asset as determined using the rules under § 1.168(i)-8(c)(4).

Accordingly:

(a) Each building, including its structural components, is a single unit of property; and

(b) If the taxpayer places in service an improvement or addition to an asset after the taxpayer placed the asset in service, the improvement or addition, including any of its structural components, is a separate unit of property.

(2) Special rule for integrated facilities. Solely for purposes of satisfying the integral part requirement, in the case of multiple properties that operate as an integrated facility (as evidenced by their actual operation) and that are physically located or co-located on the same piece or contiguous pieces of land, all properties comprising the integrated facility may be treated as a single unit of property. A property that is comprised solely of ineligible property (as described in section 4.07 of this notice) may not be treated as operating as an integrated facility with other properties and may not be treated as a single unit of property with other properties that comprise an integrated facility.

.04 Original use commences with the taxpayer. For purposes of determining whether property satisfies the original use requirement, a taxpayer applies rules consistent with § 1.168(k)-2(b)(3)(ii)(A) through (C).

.05 Determination of when construction begins. For purposes of determining whether property satisfies the beginning of construction requirement, a taxpayer applies

rules consistent with § 1.168(k)-2(b)(5)(iv)(B), including the safe harbor provided in § 1.168(k)-2(b)(5)(iv)(B)(2).

.06 Special rule for certain property not previously used in a QPA.

(1) In general. In the case of used property acquired by a taxpayer after January 19, 2025, and before January 1, 2029, the original use requirement and beginning of construction requirement are treated as met if the following requirements are satisfied:

(a) Such property was not used in a QPA (determined without regard to whether such activity resulted in a substantial transformation of the property comprising a qualified product) by any person at any time during the period beginning on January 1, 2021, and ending on May 12, 2025;

(b) Such property was not used by the taxpayer at any time prior to such acquisition;

(c) The acquisition of such property meets the requirements of § 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

(d) The acquisition of such property meets the requirements of § 179(d)(3) and § 1.179-4(d) (cost of property).

(2) Property was not used by the taxpayer at any time prior to acquisition. For purposes of determining whether used property meets the requirement in section 4.06(1)(b) of this notice, a taxpayer applies rules consistent with the used property acquisition requirements in §§ 1.168(k)-2(b)(3)(iii)(B), 1.168(k)-2(b)(3)(iv)(D)(1)(i), and 1.1502-68(b).

(3) Section 179 requirements. For purposes of determining whether used property

meets the requirements in section 4.06(1)(c) and (d) of this notice, a taxpayer applies rules consistent with the special rules in §§ 1.168(k)-2(b)(3)(iii)(C), 1.168(k)-2(b)(3)(iv)(D)(1)(ii), 1.168(k)-2(b)(3)(iv)(D)(2), and 1.1502-68(c).

(4) Determining used property acquisition date. For purposes of determining whether used property is acquired after January 19, 2025, and before January 1, 2029, a taxpayer applies rules consistent with § 1.168(k)-2(b)(5).

.07 Ineligible property.

(1) In general. Ineligible property includes any portion of property used for offices, administrative services, lodging, parking, sales activities, research activities, software development or engineering activities, or other functions unrelated to a QPA. See § 168(n)(2)(C) and (4)(B). Additionally, any portion of property used to store finished products and certain other items is not used as an integral part of a QPA and is thus ineligible property (see section 5.01(2)(b)(ii) of this notice).

(2) Property used for other ineligible activities. Ineligible property also includes any property, or a portion thereof, that contains a manufacturing, production, or refining activity, or any other activity, that is not within the scope of section 5.01 of this notice. For example, a property that exclusively contains activities described in section 5.01(3) of this notice is ineligible property.

.08 Allocation of basis to eligible property.

(1) In general. A taxpayer may use any reasonable method to allocate a property's unadjusted depreciable basis between eligible property and ineligible property. For this purpose, the use of square footage, cost segregation data, architectural or engineering plans, process diagrams, or construction invoices to allocate unadjusted depreciable

basis to eligible property may be a reasonable method. For example, assume that a taxpayer constructs property and 50 percent of the square footage of the property is eligible property. The taxpayer may determine the unadjusted depreciable basis of the eligible property by multiplying the unadjusted depreciable basis of the property by 50 percent. A taxpayer may use more than one reasonable allocation method for a property if using a single allocation method would not properly allocate unadjusted depreciable basis between eligible and ineligible property. Each allocation method must be applied consistently and reflect the property's facts and circumstances. Using employee headcount or employee time spent on QPA activities is not a reasonable method to allocate unadjusted depreciable basis to eligible property.

(2) Dual-use infrastructure. In the case of property or a portion thereof which contains infrastructure that serves both eligible property and ineligible property (such as a central air conditioning system or a sprinkler system), a taxpayer may allocate the basis of such property between eligible property and ineligible property using any reasonable method. For this purpose, the use of architectural or engineering plans, blueprints, process diagrams, product specifications, or a combination thereof, to allocate unadjusted depreciable basis to eligible property may be a reasonable method if the resulting allocation takes into account the actual or planned usage of the dual-use infrastructure. A taxpayer may also use the same allocation method from section 4.08(1) of this notice if such allocation takes into account the actual or planned usage of the dual-use infrastructure.

.09 Designating the amount of QPP. A taxpayer designates the dollar amount of eligible property that the taxpayer intends to treat as QPP on a property-by-property

basis. A taxpayer designates the dollar amount of eligible property by either designating the entire unadjusted depreciable basis of eligible property as QPP or designating a specific dollar amount (not to exceed the unadjusted depreciable basis of the eligible property) as QPP. The amount of the unadjusted depreciable basis of eligible property designated as QPP must be included in the taxpayer's election statement under section 7 of this notice. An election statement made under section 7 of this notice that does not designate a specific dollar amount of the eligible property's unadjusted depreciable basis as QPP will be treated as designating the entire unadjusted depreciable basis of eligible property as QPP.

.10 Elections out of other special depreciation allowances. For purposes of the elections out of § 168(k), (l), and (m) under § 168(k)(7), (l)(3)(D), and (m)(2)(B)(iii), respectively, QPP is treated as a separate class of property and a taxpayer is treated as having made the applicable election(s) out of §§ 168(k), (l), and (m) with respect to any QPP as part of making the election under section 7 of this notice to designate all or a portion of eligible property as QPP. See § 168(n)(4)(A).

.11 Automatic extension of placed-in-service-date requirement under certain circumstances. An automatic one-year extension of the placed-in-service-date requirement is granted for any property that is located in a disaster area (as defined in § 165(i)(5)(B)) at any time during 2030 (affected property). Accordingly, for affected property, the requirement to place property in service before January 1, 2031, is automatically extended to January 1, 2032. If a taxpayer applies the automatic extension of the placed-in-service-date requirement provided in this section 4.11, the taxpayer must include a declaration to that effect on the election statement required

under section 7 of this notice.

.12 Examples. The following examples illustrate the rules set forth in this notice:

(1) Example 1.

(a) Facts. In 2026, Company A, a calendar-year taxpayer, begins construction on a 200,000-square-foot building (Factory A) located in the United States that Company A will use in its trade or business to conduct a manufacturing activity that is a QPA (as defined in section 5 of this notice). By applying rules consistent with § 1.168(k)-2(b)(5)(iv)(B), Company A determines that construction of Factory A began in February 2026. Construction of Factory A was completed in November 2027, and Factory A was placed in service in December 2027. Upon completion, Factory A has an unadjusted depreciable basis of \$60,000,000. No activities are conducted in, or take place within, Factory A except for Company A's manufacturing activity and Factory A does not contain any space that is ineligible property under section 4.07 of this notice. Factory A is not subject to the alternative depreciation system under § 168(g). On Company A's timely filed original Federal income tax return for its taxable year ending December 31, 2027, Company A designates \$50,000,000 of Factory A's \$60,000,000 unadjusted depreciable basis as QPP in an election statement that is consistent with the requirements in section 7 of this notice.

(b) Analysis. Factory A's entire unadjusted depreciable basis of \$60,000,000 is allocable to eligible property because (i) Factory A is nonresidential real property, (ii) Factory A is MACRS property, (iii) all of Factory A is used as an integral part of a QPA, (iv) Factory A's original use commenced with Company A, (v) Factory A's construction began after January 19, 2025, and before January 1, 2029, (vi) Factory A is

placed in service after July 4, 2025, and before January 1, 2031, (vii) Factory A is not ADS property, and (viii) Factory A is not ineligible property. Accordingly, Company A has QPP of \$50,000,000, equal to the amount of eligible property designated as QPP by Company A on the election statement filed with its timely filed original Federal income tax return.

(2) Example 2.

(a) Facts. The facts are the same as in Example 1, except that Factory A contains 6,000 square feet of office space and 4,000 square feet of other space not used as an integral part of a QPA, and Company A makes an election to use the de minimis rule described in section 4.02(2) of this notice.

(b) Analysis. Out of Factory A's total square footage of 200,000 square feet, only 190,000 square feet satisfies the integral part requirement as Factory A also contains 6,000 square feet of office space and 4,000 square feet of other space that is not used as an integral part of a QPA. As the square footage that satisfies the integral part requirement is 95% (190,000 square feet / 200,000 square feet) of Factory A's total square footage, and Company A made an election to use the de minimis rule described in section 4.02(2) of this notice, Factory A satisfies the de minimis rule described in section 4.02(2) of this notice and Company A may treat the entire square footage of Factory A as satisfying the integral part requirement.

Therefore, Factory A's entire unadjusted depreciable basis of \$60,000,000 is allocable to eligible property because (i) Factory A is nonresidential real property, (ii) Factory A is MACRS property, (iii) the entire square footage of Factory A is treated as used by Company A as an integral part of a QPA due to the application of the de

minimis rule in section 4.02(2) of this notice, (iv) Factory A's original use commenced with Company A, (v) Factory A's construction began after January 19, 2025, and before January 1, 2029, (vi) Factory A is placed in service after July 4, 2025, and before January 1, 2031, (vii) Factory A is not ADS property, and (viii) Factory A is not ineligible property. Accordingly, Company A has QPP of \$50,000,000, equal to the amount of eligible property designated as QPP by Company A on the election statement filed with its timely filed original Federal income tax return.

(3) Example 3.

(a) Facts. Company A, a calendar-year taxpayer, previously placed in service a building (Factory B) during its taxable year ended December 31, 2023, and has since used Factory B to conduct manufacturing activities which constitute a QPA (as defined in section 5 of this notice). No activities are conducted in, or take place within, Factory B except for Company A's manufacturing activities and Factory B does not contain any space that is ineligible property under section 4.07 of this notice.

In May 2028, Company A begins construction of an upgrade to Factory B's power distribution system (Electrical System Upgrade) and places the Electrical System Upgrade in service in June 2028. The cost of the Electrical System Upgrade is \$2,000,000, which Company A capitalizes pursuant to § 1.263(a)-3. The Electrical System Upgrade is qualified improvement property under § 168(e)(6).

(b) Analysis. Under section 4.03(1)(b) of this notice, Factory B and the Electrical System Upgrade are treated as separate units of property. However, because Factory B and the Electrical System Upgrade operate as an integrated facility and are physically located on the same piece of land, Factory B and the Electrical System Upgrade may

be treated as a single unit of property under section 4.03(2) of this notice for purposes of satisfying the integral part requirement. Accordingly, whether the Electrical System Upgrade satisfies the integral part requirement, either in whole or in part, is determined by reference to whether Factory B satisfies the integral part requirement, either in whole or in part.

The entire unadjusted basis of the Electrical System Upgrade of \$2,000,000 is allocable to eligible property because (i) the Electrical System Upgrade is nonresidential real property, (ii) the Electrical System Upgrade is MACRS property, (iii) all of Factory B is used by Company A as an integral part of a QPA, (iv) the Electrical System Upgrade's original use commenced with Company A, (v) the Electrical System Upgrade's construction began after January 19, 2025, and before January 1, 2029, (vi) the Electrical System Upgrade is placed in service after July 4, 2025, and before January 1, 2031, (vii) the Electrical System Upgrade is not ADS property, and (viii) the Electrical System Upgrade is not ineligible property. Accordingly, Company A may designate up to \$2,000,000 of the eligible property as QPP if it does so in the manner provided in section 4.09 of this notice in an election made in the time and manner provided in section 7 of this notice. In addition, Company A is treated as having made an election under § 168(k)(7) not to deduct the additional first year depreciation under § 168(k) with respect to any portion of the unadjusted depreciable basis of the Electrical System Upgrade which Company A designates as QPP in an election under section 7 of this notice.

(4) Example 4.

(a) Facts. The facts are the same as in Example 3. In December 2028,

Company A performs routine maintenance on Factory B's electrical system at a cost of \$100,000. Company A elects to treat the maintenance cost as an amount paid or incurred to improve the electrical system and capitalizes such cost under § 1.263(a)-3(n). The capitalized maintenance costs are qualified improvement property under § 168(e)(6).

(b) Analysis. Under section 4.03(1)(b) of this notice, Factory B and the capitalized maintenance costs are treated as separate units of property. However, because Factory B and the capitalized maintenance costs operate as an integrated facility and are physically located on the same piece of land, Factory B and the capitalized maintenance costs may be treated as a single unit of property under section 4.03(2) of this notice for purposes of satisfying the integral part requirement. Accordingly, whether the capitalized maintenance costs satisfy the integral part requirement is determined by reference to whether Factory B, either in whole or in part, satisfies the integral part requirement.

The entire unadjusted depreciable basis of the capitalized maintenance costs of \$100,000 is allocable to eligible property because (i) the capitalized maintenance costs are nonresidential real property, (ii) the capitalized maintenance costs are MACRS property, (iii) all of Factory B is used by Company A as an integral part of a QPA, (iv) the capitalized maintenance costs' original use commenced with Company A, (v) the capitalized maintenance costs' construction began after January 19, 2025, and before January 1, 2029, (vi) the capitalized maintenance costs are placed in service after July 4, 2025, and before January 1, 2031, (vii) the capitalized maintenance costs are not ADS property, and (viii) the capitalized maintenance costs are not ineligible property.

Accordingly, Company A may designate up to \$100,000 of the eligible property as QPP if it does so in the manner provided in section 4.09 of this notice in an election made in the time and manner provided in section 7 of this notice. In addition, Company A is treated as having made an election under § 168(k)(7) not to deduct the additional first year depreciation under § 168(k) with respect to any portion of the unadjusted depreciable basis of the capitalized maintenance costs which Company A designates as QPP in an election under section 7 of this notice.

(5) Example 5.

(a) Facts. Company A, a calendar-year taxpayer, previously placed in service two buildings (Factory B and Factory C) during its taxable year ended December 31, 2023, on a single piece of land located in in the United States and has since used Factory B and Factory C to conduct manufacturing activities which constitute a QPA (as defined in section 5 of this notice). No activities are conducted in, or take place within, Factory B and Factory C except for Company A's manufacturing activities and Factory B and Factory C do not contain any space that is ineligible property under section 4.07 of this notice.

In 2026, Company A, begins construction on a new building (Building A) which is located on a contiguous piece of land to Factory B and Factory C. Building A will be used to store raw materials and other manufacturing inputs used or consumed during the manufacturing activities taking place within Factory B and Factory C. By applying rules consistent with § 1.168(k)-2(b)(5)(iv)(B), Company A determines that construction of Building A began in May 2026. Construction of Building A was completed in March 2027, and Building A was placed in service in April 2027. Upon completion, Building A

has an unadjusted depreciable basis of \$20,000,000. No activities are conducted in, or take place within, Building A except for Company A's storage of raw materials and other manufacturing inputs and Building A does not contain any space that is ineligible property under section 4.07 of this notice. Building A is not subject to the alternative depreciation system under § 168(g).

(b) Analysis. Under section 4.03(1)(a) of this notice, Building A, Factory B, and Factory C are each treated as a separate unit of property. However, as Building A, Factory B, and Factory C operate as an integrated facility (as evidenced by their actual operation) and are physically located on contiguous pieces of land, under section 4.03(2) of this notice, Company A may treat all three buildings as a single unit of property for purposes of satisfying the integral part requirement. Accordingly, Building A satisfies the integral part requirement because, when its activities are combined with the activities of Factory B and Factory C, Building A is used as an integral part of a QPA (as defined in section 5 of this notice).

Building A's entire unadjusted depreciable basis of \$20,000,000 is allocable to eligible property because (i) Building A is nonresidential real property, (ii) Building A is MACRS property, (iii) Building A is used by Company A as an integral part of a QPA because Building A, Factory B, and Factory C are an integrated facility, (iv) Building A's original use commenced with Company A, (v) Building A's construction began after January 19, 2025, and before January 1, 2029, (vi) Building A is placed in service after July 4, 2025, and before January 1, 2031, (vii) Building A is not ADS property, and (viii) Building A is not ineligible property. Accordingly, Company A may designate all or any portion of the eligible property as QPP if it does so in the time and manner provided

in section 4.09 of this notice in an election made in the manner provided in section 7 of this notice.

(6) Example 6.

(a) Facts. In 2027, Company C, a calendar-year taxpayer, begins constructing a building (Factory D), in the United States which Company C will use in its trade or business as an automobile plant. Company C will use Factory D to assemble and combine engines, transmissions, chassis, and other produced subcomponents and purchased inputs into a finished automobile using various processes, including molding, welding, stamping, and other similar activities, that materially change the form or function of the input materials and components such that they are distinguishable from, and cannot be readily returned to, their original state. By applying rules consistent with § 1.168(k)-2(b)(5)(iv)(B), Company C determines that construction of Factory D began in August 2027. Construction of Factory D was completed in September 2029, and Factory D was placed in service in October 2029. Upon completion, Factory D has an unadjusted depreciable basis of \$60,000,000. No portion of Factory D is used to perform activities described in section 4.07 of this notice. Factory D is not subject to the alternative depreciation system under § 168(g).

(b) Analysis. Company C's trade or business activity conducted in Factory D is manufacturing, as defined in section 5.02(5) of this notice, and constitutes a QPA under section 5.01(1) of this notice. Factory D is eligible property because (i) it is nonresidential real property, (ii) it is MACRS property, (iii) all of Factory D is used by Company C as an integral part of a QPA, (iv) its original use commenced with Company C, (v) its construction began after January 19, 2025, and before January 1, 2029, (vi) it

is placed in service after July 4, 2025, and before January 1, 2031, (vii) it is not ADS property, and (viii) it is not ineligible property. Accordingly, Company C may designate up to \$60,000,000 of the eligible property's unadjusted depreciable basis as QPP provided it does so in the manner provided in section 4.09 of this notice in an election made in the time and manner provided in section 7 of this notice.

SECTION 5. QUALIFIED PRODUCTION ACTIVITY

.01 Qualified production activity.

(1) In general. The term qualified production activity (QPA) means the manufacturing, production, or refining of a qualified product. A trade or business activity of a taxpayer does not constitute manufacturing, production, or refining of a qualified product unless the trade or business activity of such taxpayer results in a substantial transformation of the property comprising the qualified product (as defined in section 5.02(9) of this notice). A manufacturing, production, or refining activity (for example, a manufacturing or production subprocess), or a related activity, that does not itself give rise to a substantial transformation of the property comprising a qualified product may nevertheless be included in a QPA, or will not cause a taxpayer to fail to have a QPA, if such activity meets the requirements of section 5.01(2) or (3) of this notice.

(2) Essential activities.

(a) In general. A QPA includes any manufacturing, production, or refining activity that does not result in a substantial transformation of the property comprising a qualified product if the activity is essential to the completion of the QPA. A manufacturing, production, or refining activity is essential to the completion of a QPA if:

(i) the activity occurs within the same property, or within the same integrated

facility (as determined under section 4.03(2) of this notice), in which the substantial transformation of the property comprising the qualified product occurs;

(ii) the activity does not occur within ineligible property described in section 4.07(1) of this notice; and

(iii) without the activity, the substantial transformation of the property comprising the qualified product:

(A) cannot occur,

(B) would result in an end product that is different in quality than the intended qualified product, or

(C) would result in a quantity of qualified product that is different from the intended quantity.

(b) Treatment of storage space and loading bays.

(i) Storage of raw materials. The receiving and storage of raw materials or other inputs to be used or consumed during a QPA are activities essential to the QPA if they are conducted in, or take place within, the same property, or within the same integrated facility (as determined under section 4.03(2) of this notice), as the QPA.

(ii) Storage of other items. Any other storage activity not described in section 5.01(2)(b)(i) of this notice, such as the storage of finished products, is not an activity essential to a QPA.

(3) Related activities.

(a) In general. A taxpayer's trade or business activity will not fail to be a QPA if the individuals performing or supervising the manufacturing, production, or refining activities described in either section 5.01(1), (2)(a), or (2)(b)(i) of this notice also

perform, or are otherwise involved in, activities related to the QPA if: (i) the related activity occurs within the same property, or within the same integrated facility (as determined under section 4.03(2) of this notice) in which the substantial transformation of the property comprising the qualified product occurs and (ii) the related activity does not occur within ineligible property described in section 4.07(1) of this notice. The following activities are examples of other trade or business activities that may be related to a QPA:

(i) Oversight and direction of the manufacturing, production, or refining activities that result in the substantial transformation of the property comprising a qualified product;

(ii) Material selection, vendor selection, or control of the raw materials or work-in-process that are substantially transformed into a qualified product;

(iii) Management of manufacturing, production, or refining costs or capacities attributable to the manufacturing, production, or refining activities that result in a substantial transformation of the property comprising a qualified product (for example, cost reduction or efficiency initiatives associated with the manufacturing, production, or refining activities that result in a substantial transformation of the property comprising a qualified product); or

(iv) Developing, or directing the use or development of, product design and design specifications, as well as trade secrets, technology, or other intellectual property used in conducting a manufacturing, production, or refining activity that results in a substantial transformation of the property comprising the qualified product.

(b) No substantial transformation. If a taxpayer's trade or business activity within

a property or portion thereof includes only activities described in section 5.01(3)(a)(i)-(iv) of this notice, the taxpayer's trade or business activity that takes place within that property or portion thereof does not result in substantial transformation of the property comprising a qualified product. Accordingly, the taxpayer's trade or business activity within that property or portion thereof will not be a QPA.

(4) Ownership of the qualified product. For purposes of determining whether a taxpayer's trade or business activity is a QPA, whether the taxpayer is the tax owner of the qualified product resulting from the QPA is not taken into account to determine whether the taxpayer's trade or business activity is a QPA. For example, a trade or business activity conducted by a taxpayer in which it enters into contract manufacturing arrangements to manufacture, produce, or refine a qualified product for its customers, but under which the taxpayer does not own the resulting qualified product, constitutes a QPA if such activity otherwise meets the definitions and rules provided in this section 5.

.02 Defined terms. For purposes of this notice:

(1) Production. The term production means either agricultural production or chemical production.

(2) Qualified product. The term qualified product means any tangible personal property, except any food or beverage prepared in the same building as a retail establishment in which such property is sold.

(3) Tangible personal property. The term tangible personal property has the same meaning as in § 1.48-1(c).

(4) Retail establishment. The term retail establishment means a retail sales facility as defined in § 1.263A-3(c)(5)(ii)(B).

(5) Manufacturing. The term manufacturing means to materially change the form or function of tangible personal property, including parts and components, to create a new item of tangible personal property that is held for rent, lease, or sale to customers in the ordinary course of a trade or business. The form or function of the raw materials, elements, parts, components, or other tangible personal property used as inputs is considered to be materially changed if, at the completion of the processes giving rise to the new item of tangible personal property, the materials, elements, parts, components or other inputs have been transformed such that they are distinguishable from, and cannot readily be returned to, their original state. In no event will a change in form or function resulting solely from packaging, repackaging, labeling, minor assembly operations, or a combination thereof, be considered a material change to the form or function of tangible personal property.

(6) Refining. The term refining means to purify a substance into a useful and higher-value product. Examples of refining include—

(a) Removing free fatty acids and other impurities from animal fats by degumming, decolorization, deacidification, and deodorization;

(b) Processing petroleum, liquid hydrocarbons and other products from crude oil by using fractionation, straight distillation of crude oil, and/or cracking;

(c) Purifying nonferrous metals (except aluminum) by electrolytic methods or other processes;

(d) Processing vegetable oils from plant material by removing free fatty acids, phospholipids, pigments, off-flavors, and other impurities;

(e) Processing vegetable, oilseed, and tree nut oils from purchased oils, such as

by degumming and neutralization;

(f) Wet corn milling;

(g) Processing cane or beet sugar from raw cane or beet sugar;

(h) Removing remaining impurities and moisture from animal fat, bones, and meat scraps through techniques like filtration and bleaching;

(i) Processing tar paving, roofing, and saturated materials from crude petroleum and manufacturing asphalt;

(j) Extracting alumina (aluminum oxide) generally from bauxite ore;

(k) Processing liquified natural gas or chemical feedstocks from natural gas;

(l) Recovering copper or copper alloys from scrap; and

(m) Recovering nonferrous metals (except copper and aluminum) from scrap.

(7) Agricultural production.

(a) In general. The term agricultural production means the process of cultivating the ground, typically in fields or large acreage, and includes:

(i) Preparing the soil;

(ii) Planting seeds;

(iii) Raising, cultivating, irrigating, and harvesting crops for sale, rent, or lease to customers; and

(iv) Breeding, rearing, feeding, and managing livestock for sale, rent, or lease to customers.

(b) Exclusions. The term agricultural production does not include—

(i) The raising of animals that are not livestock; or

(ii) Activities that benefit persons engaged in agriculture when these activities

are not agricultural production, such as food marketing.

(c) Livestock. The term livestock includes cattle, hogs, horses, mules, donkeys, sheep, goats, captive fur-bearing animals, chickens, turkeys, pigeons, and other poultry.

(8) Chemical production. The term chemical production means a chemical process whereby a product is formulated from organic and inorganic raw materials, including preparing raw materials for reaction, combining materials in a reactor to form a new substance, isolating the final product from byproducts, intermediates, and other substances, and purifying the final product. Examples of chemical production include—

(a) Basic inorganic chemical manufacturing, such as petrochemical manufacturing, industrial gas manufacturing, and synthetic dye and pigment manufacturing;

(b) Basic organic chemical manufacturing, such as ethyl alcohol manufacturing and cyclic crude, intermediate, and gum and wood chemical manufacturing;

(c) Manufacturing synthetic resins, plastics materials, and non-vulcanizable elastomers and mixing and blending resins on a custom basis;

(d) Manufacturing nitrogenous or phosphatic materials and mixing with other ingredients into fertilizers;

(e) Manufacturing pharmaceutical products intended for internal and external consumption in such forms as ampoules, tablets, capsules, vials, ointments, powders, solutions, and suspensions;

(f) Manufacturing adhesives, glues, and caulking compounds; and

(g) Manufacturing soaps, detergents, polishes, surface active agents, textile and leather finishing agents, and other sanitation goods.

(9) Substantial transformation of the property comprising a qualified product.

(a) In general. The term substantial transformation of the property comprising a qualified product means the further manufacturing, production, or refining of the constituent elements, raw materials, inputs, or subcomponents into a final, complete, and distinct item of property in the hands of the taxpayer that is fundamentally different from the original constituent elements, materials, inputs, or subcomponents.

(b) Examples of substantial transformation of the property comprising a qualified product. Examples of substantial transformation of the property comprising a qualified product include the conversion of wood pulp to paper, steel rods to screws and bolts, and freshly caught tuna fish to canned tuna.

(c) Example of an activity that does not result in a substantial transformation of the property comprising a qualified product. An example of an activity that does not result in a substantial transformation of the property comprising a qualified product is the grouping and packaging of multiple finished goods for sale as a single item, such as gift baskets, subscription boxes, and bundled electronics.

(d) No application to other provisions. The definition of the term substantial transformation of the property comprising a qualified product set forth in section 5.02(9)(a) of this notice, and the illustrative examples contained in this notice, are limited to determinations under § 168(n), and do not apply with respect to determinations of whether property has been substantially transformed for any other purpose, including for purposes of any other provision of the Code or the regulations thereunder.

.03 Safe harbor for property placed in service during 2025.

(1) In general. Notwithstanding the definitions in section 5.02(5), (6), (7), and (8) of this notice, for property placed in service after July 4, 2025, and on or before December 31, 2025, the taxpayer's trade or business activity conducted in, or taking place within, the property will be treated as a QPA under section 5.01 of this notice if (a) the principal business activity code that the taxpayer, or the relevant trade or business of the taxpayer, used on its most recently filed Federal income tax return (for example, 2024 Form 1040, Schedule C, line B; 2024 Form 1065, Item A; 2024 Form 851, Part II, or 2024 Form 1120, Schedule K, line 2a), filed before February 19, 2026, is an applicable NAICS code listed in section 5.03(2) of this notice and (b) such activity results in, or is otherwise essential to (as determined under 5.01(2) of this notice), the substantial transformation of the property comprising a qualified product (as defined in section 5.02(9) of this notice). For a taxpayer that does not have such a filed Federal income tax return because it is filing its first Federal income tax return on or after February 19, 2026, the taxpayer must reasonably determine that its principal business activity code is an applicable NAICS code on its first Federal income tax return to be eligible for the safe harbor provided in this section 5.03.

(2) Applicable NAICS code. An applicable NAICS code means any of the NAICS codes listed under sectors 31, 32, or 33, or under subsectors 111 or 112, that appear in the North American Industry Classification System (NAICS), United States, 2022, published by the Office of Management and Budget (OMB), Executive Office of the President.²

.04 Example. The following example illustrates the rules set forth in section 5 of this

² https://www.census.gov/naics/reference_files_tools/2022_NAICS_Manual.pdf.

notice:

(1) Facts. Company B owns Factory B, a building, and uses Factory B to process tomatoes, onions, garlic, and other ingredients (collectively the sauce ingredients) into jarred tomato sauce for sale in grocery stores (jarred sauce). The jarred sauce is a qualified product, and the sauce ingredients are the property comprising the qualified product. The physical space of Factory B exclusively contains the following: a loading bay used to receive the sauce ingredients (ingredient receiving); a section used to store the sauce ingredients received at the loading bay (ingredient storage); a section used to, as applicable to each ingredient, inspect, sort, clean, blanch, peel, chop, mince, and/or otherwise prepare the sauce ingredients for further processing (ingredient preparation); a manufacturing space in which the prepared ingredients are combined, blended, cooked, cooled, preserved, and sealed in labeled jars (sauce processing and sauce jarring); and a section used to store the jarred sauce prior to shipping to customers (sauce storage).

(a) Ingredient receiving and ingredient storage. Individuals working in the ingredient receiving and storage sections of Factory B exclusively engage in receiving and storage related activities. The form or function of any sauce ingredient is not materially changed from its original state into a new item of tangible personal property through the activities conducted in the loading bay and ingredient storage sections of Factory B.

(b) Ingredient preparation. During the ingredient preparation stage, the forms of the sauce ingredients are materially changed from their original state such that new items of tangible personal property result (prepared ingredients), but further processing

is required beyond the ingredient preparation stage to arrive at a final, complete, and distinct item of property (jarred sauce) that is fundamentally different from the original inputs. However, without this ingredient preparation stage, the sauce processing stage would result in an end product that is different in quality or quantity from the intended qualified product. In addition to performing the inspecting, sorting, cleaning, blanching, peeling, chopping, mincing, and other preparation activities, the individuals working in ingredient preparation also perform tests to ensure that the prepared ingredients are of the appropriate quality before they are further processed as a part of the sauce processing and jarring activities.

(c) Sauce processing and sauce jarring. During the sauce processing and sauce jarring stage, the forms of the prepared ingredients are further materially changed into the final, complete, and distinct item of property (jarred sauce). The individuals working in sauce processing and sauce jarring also perform oversight activities to ensure the manufacturing process occurs as intended.

(d) Sauce storage. Individuals working in this section of Factory B exclusively engage in storage related activities of the jarred sauce. The form or function of the jarred sauce is not further materially changed through the activities conducted in this section of Factory B.

(2) Analysis.

(a) Existence of a manufacturing activity in Factory B. The ingredient preparation, sauce processing, and sauce jarring activities are manufacturing as defined in section 5.02(5) of this notice as the forms of the ingredients and the prepared ingredients (during the ingredient preparation activities and the sauce processing and

sauce jarring activities, respectively) are materially changed into a new item of tangible personal property (the jarred sauce), which Company B sells to customers in the ordinary course of its trade or business. Company B's other activities conducted in Factory B (the ingredient receiving, ingredient storage, and sauce storage activities) are not manufacturing under section 5.02(5) of this notice as the forms or functions of the sauce ingredients and the jarred sauce are not materially changed during such activities.

(b) Existence of a QPA in Factory B. While both the ingredient preparation and sauce processing and jarring stages are manufacturing, a substantial transformation of the property comprising a qualified product occurs only during the sauce processing and sauce jarring stage because only in this stage are the constituent inputs (the prepared ingredients) further manufactured into a final, complete, and distinct item of property (jarred sauce) that is fundamentally different from the original constituent inputs (the sauce ingredients). Under section 5.01(1) of this notice, Company B's sauce processing and jarring activity conducted in Factory B is a QPA.

(c) Scope of Factory B's QPA.

(i) Ingredient preparation. The material change occurring in the ingredient preparation stage is not sufficient to constitute a substantial transformation of the sauce ingredients because the prepared ingredients do not represent a final, complete, and distinct item of property that is fundamentally different from the sauce ingredients. However, the ingredient preparation stage is an essential activity under section 5.01(2) of this notice as (A) it is a manufacturing activity that occurs within the same property (Factory B) as the substantial transformation of the property, (B) it does not occur in

ineligible property described in section 4.07(1) of this notice, and (C) without the ingredient preparation stage, the sauce processing and jarring stage would result in an end product that is different in quality or quantity from the intended end product.

Accordingly, under section 5.01(2)(a) of this notice, the ingredient preparation activities are essential activities, and thus are included in Company B's QPA conducted in Factory B.

(ii) Loading bay and ingredient storage activities. The ingredient receiving activities at the loading bay and the ingredient storage activities relate to raw materials to be consumed in the QPA (the sauce ingredients) and are conducted in the same property as the QPA (Factory B). Accordingly, the ingredient receiving and ingredient storage activities are essential activities under section 5.01(2)(b) of this notice and thus are included in Company B's QPA conducted in Factory B.

(iii) Related activities. In addition to the core activities conducted in the ingredient preparation and sauce processing and sauce jarring stages, the individuals working in those sections of Factory B also perform quality testing and oversight activities. As the quality testing and oversight activities occur within the same property in which the substantial transformation of property comprising the qualified product occurs (Factory B) and do not occur within ineligible property under section 4.07(1) of this notice, the quality testing and oversight activities will not cause Company B to fail to have a QPA under section 5.01(3)(a) of this notice.

(iv) Ineligible property. Under section 5.01(2)(b)(ii) of this notice, storage of finished products is not an essential activity, and under section 4.07(2) of this notice, any property, or a portion thereof, used to conduct storage activities described in section

5.01(2)(b)(ii) of this notice is ineligible property. Accordingly, the portion of Factory B used to conduct the sauce storage is ineligible property.

(v) Summary of Factory B's QPA. The scope of the QPA conducted in, or taking place within, Factory B thus includes the ingredient receiving and storage stage, the ingredient preparation stage, and the sauce processing and jarring stages, including the quality testing and oversight activities performed by individuals working in those sections or stages of Factory B.

SECTION 6. SPECIAL RULES

.01 Property placed in service and disposed of in the same taxable year. If property is placed in service and disposed of during the same taxable year, a taxpayer applies rules consistent with § 1.168(k)-2(g)(1).

.02 Redetermination of basis. If the unadjusted depreciable basis of QPP is redetermined before January 1, 2031 (for example, due to a contingent purchase price or discharge of indebtedness), the deduction determined under § 168 is redetermined under rules consistent with § 1.168(k)-2(g)(2)(i)-(iii).

.03 Like-kind exchanges and involuntary conversions. For replacement MACRS property (as defined in § 1.168(i)-6(b)(1)) that is QPP at the time of replacement and the time of replacement of which is after January 19, 2025, and before January 1, 2029, a taxpayer applies rules consistent with § 1.168(k)-2(g)(5).

SECTION 7. TIME AND MANNER OF MAKING ELECTION

.01 Time for making election and designation. A taxpayer designates, under section 4.09 of this notice, and elects to treat property as QPP by making the election under this section 7 by the due date, including extensions, of the taxpayer's original Federal

income tax return for the taxable year in which the eligible property is placed in service by the taxpayer.

.02 Manner of making election and designation. A taxpayer makes a designation and an election under this section 7 by attaching a statement to its Federal income tax return for the taxable year in which the eligible property is placed in service. The designation and election are made separately by each person owning the eligible property (for example, for each member of a consolidated group by the agent for the group (within the meaning of § 1.1502-77(a) and (c)). The statement, entitled “STATEMENT PURSUANT TO SECTION 7 OF NOTICE 2026-16”, must include the following information—

(1) The name and taxpayer identification number of the taxpayer making the election;

(2) For each property placed in service in the taxable year for which an election under this section 7 is being made:

(a) The street address, city, state, zip code, and a description of the property;

(b) The total unadjusted depreciable basis of the property;

(c) If the eligible property is less than the entire property, the dollar amount of unadjusted depreciable basis allocable to the eligible property, and a description that identifies the eligible property; and

(d) The dollar amount of the unadjusted depreciable basis of eligible property the taxpayer is designating as QPP (or a statement that the taxpayer is designating the entire unadjusted depreciable basis of the eligible property as QPP);

(3) If the taxpayer is applying the de minimis rule described in section 4.02(2) of

this notice to an eligible property, a declaration that the taxpayer is applying the de minimis rule described in section 4.02(2) of Notice 2026-16 and identification of each eligible property to which the de minimis rule is applied; and

(4) If the taxpayer is using the automatic one-year extension of the placed-in-service-date requirement in section 4.11 of this notice—

(a) A declaration that—

(i) The taxpayer is using the automatic one-year extension of the placed-in-service-date requirement in section 4.11 of Notice 2026-16; and

(ii) Each property for which the taxpayer is using the automatic one-year extension was located in a disaster area for all or a portion of 2030; and

(b) Identification of each eligible property listed under section 7.02(2) of this notice for which the taxpayer is using the automatic one-year extension of the placed-in-service-date requirement in section 4.11 of this notice, and identification of the federally declared disaster (as defined in § 165(i)(5)) that established the disaster area applicable to each eligible property.

.03 Revocation. Any election made under section 7 of this notice, and any designation under section 4.09 of this notice contained in such election, may be revoked only by filing a request for a private letter ruling and obtaining the written consent of the Secretary. The Secretary will provide consent only in extraordinary circumstances. See § 168(n)(6)(B). If the request for revocation would allow a taxpayer to use hindsight, the extraordinary circumstances standard is not met.

SECTION 8. DEPRECIATION RECAPTURE

.01 Defined terms. For purposes of this notice:

(1) QPP change in use.

(a) In general. A QPP change in use occurs if, at any time within the 10-calendar-year period beginning on the date a taxpayer places QPP in service, the QPP (i) ceases to satisfy the integral part requirement, and (ii) is used by the taxpayer in another productive use that results in the property that was previously QPP constituting disqualified property (as defined in section 8.01(2) of this notice). Accordingly, a QPP change in use has not occurred when a taxpayer ceases to use QPP as an integral part of one QPA and begins to use it as an integral part of another QPA, provided the QPP was not used in another productive use not described in section 5.01 of this notice in the interim. If only a portion of QPP undergoes a QPP change in use, this section 8 applies only to the portion that underwent a change in use, provided that the other portion(s) of the QPP continue to meet the requirements of section 4.01 of this notice.

(b) Special rule for consolidated groups. For QPP subject to an intercompany lease described in section 4.02(3)(b) of this notice, if B ceases to have a QPA that is conducted in, or takes place within, the QPP, or if S or B leaves the consolidated group, then S has a QPP change in use.

(c) Leases to commonly controlled persons. For QPP subject to a lease agreement between a lessor pass-through entity and a commonly controlled person, or between a lessor individual and a commonly controlled person, if the commonly controlled person leasing the QPP ceases to have a QPA that is conducted in, or takes place within, the QPP, or if the commonly controlled person is no longer described in section 4.02(3)(c) of this notice for any taxable year, the lessor pass-through entity or lessor individual, as applicable, has a QPP change in use.

(d) Temporarily idle property. A property that has been placed in service but is temporarily idle does not cease to satisfy the integral part requirement and does not have a QPP change in use. For this purpose, property is temporarily idle when the taxpayer takes it out of service for a finite period with the expectation of resuming a QPA in the near future (for example, property taken out of service while upgrading a production line or performing facility-wide maintenance).

(2) Disqualified property. The term disqualified property refers to QPP that underwent a QPP change in use and is no longer QPP. Disqualified property includes only the portion of the QPP that underwent a QPP change in use.

(3) Year of change. The term year of change refers to the taxable year in which a QPP change in use occurs.

.02 Application of § 1245(a)(1) upon a QPP change in use. Disqualified property is subject to § 1245(a)(1) and is treated as having been disposed of by the taxpayer as of the first time the property had a QPP change in use. Upon such QPP change in use, the excess of the recomputed basis (as defined in § 1245(a)(2)) of the disqualified property over the adjusted basis (as defined in § 1011(a)) of the disqualified property is treated as ordinary income in the year of change. To determine the recomputed basis of disqualified property, see section 8.05 of this notice.

.03 Adjustment to basis of property for gain recognized upon a change in use. The taxpayer's basis in disqualified property is increased by the amount of gain recognized under section 8.02 of this notice. Solely for purposes of determining the depreciation allowance for disqualified property after a QPP change in use, the adjustment to basis in this section 8.03 is treated as having occurred on the first day of the year of change.

.04 Determination of depreciation allowance for disqualified property. The depreciation allowance for disqualified property in the year of change and all subsequent taxable years is determined as though the disqualified property was placed in service by the taxpayer as a new separate asset on the first day of the year of change, taking into account the applicable convention.

.05 Determination of recomputed basis of disqualified property.

(1) In general. For purposes of applying § 1245(a)(1), the recomputed basis of disqualified property shall be determined by multiplying the eligible property's unadjusted depreciable basis designated as QPP by the percentage of the eligible property that underwent a change in use (as determined under section 8.05(2) of this notice). For example, assume that the entire eligible property had an unadjusted depreciable basis of \$100, and the taxpayer elected to designate \$80 of it as QPP. If 50% of the eligible property undergoes a change in use, the recomputed basis of the disqualified property under § 1245(a)(2) equals \$40 (50% of \$80).

(2) Determination of percentage of eligible property that underwent change in use.

A taxpayer may determine the portion of the eligible property (expressed as a percentage) that underwent a change in use using any reasonable method that takes into account the data and criteria described in section 4.08 of this notice. A taxpayer must use the same method of determining the portion of eligible property that underwent a change in use consistently for any subsequent partial changes in use with respect to the same eligible property.

(3) Unit-of-property determination after a partial change in use. Solely for purposes of determining whether the remaining eligible property continues to be used

as an integral part of a QPA and has not experienced a QPP change in use, the rules in section 4.03 of this notice are applied by disregarding the eligible property that underwent a change in use.

.06 Ineligibility for certain elections. Disqualified property is not eligible in the year of change for the election provided under § 179, the additional first year depreciation deduction provided in § 168(k), or the special depreciation allowances under §§ 168(l) and 168(m).

.07 Examples. The following examples illustrate the rules set forth in section 8 of this notice:

(1) Example 1.

(a) Facts. Company A, a calendar-year taxpayer, places a 50,000 square-foot factory (Factory A) consisting entirely of eligible property in service on January 1, 2027, and elects under section 7 of this notice to designate the entire \$10,000,000 unadjusted depreciable basis of Factory A as QPP. Company A's special depreciation allowance under § 168(n) for the 2027 taxable year is \$10,000,000, and Company A's adjusted basis in the QPP is \$0 as of January 1, 2028. From January 1, 2027, to December 19, 2032, Company A uses the QPP as an integral part of a QPA. However, during the remaining portion of the taxable year ending December 31, 2032 (the 2032 taxable year), Company A ceases using the property as an integral part of a QPA and begins using the property in another productive use that is not a QPA.

(b) Analysis. Under section 8.01(1)(a) of this notice, Company A's QPP underwent a QPP change in use in the 2032 taxable year and became disqualified property when Company A ceased using the QPP as an integral part of a QPA and

began using the property in another productive use. Under section 8.02 of this notice, Company A is treated as disposing of the QPP and recognizes a gain of \$10,000,000 in the 2032 taxable year which is treated as ordinary income. Under section 8.03 of this notice, Company A's adjusted basis of \$0 in the disqualified property is increased by \$10,000,000 as of January 1, 2032, for purposes of determining the depreciation allowance for the disqualified property starting in the 2032 taxable year.

Under section 8.04 of this notice, Company A determines its depreciation allowance for the disqualified property in the year of change and all subsequent taxable years by treating the disqualified property as a new separate asset placed in service on the first day of the year of change, taking into account the applicable convention. As the disqualified property is nonresidential real property, the depreciation allowance is determined using the straight line method under § 168(b)(3) and the mid-month convention under § 168(d)(2). Accordingly, for the 2032 taxable year, Company A has a depreciation allowance of \$245,726, equal to the unadjusted basis of \$10,000,000 divided by 39 years, times 11.5 divided by 12 months.

(2) Example 2.

(a) Facts. The facts are the same as in Example 1, except (i) Company A only designated \$8,000,000 of Factory A's unadjusted depreciable basis as QPP, and (ii) during the remaining portion of the 2032 taxable year, only 25,000 square feet of Factory A underwent a change in use. Assume Company A's determination that only 25,000 square feet of Factory A underwent a change in use was made in accordance with section 8.05(2) of this notice, and that the remaining 25,000 square feet of Factory A continue to meet the requirements of section 4.01 of this notice without regard to the

25,000 square feet that underwent a change in use.

(b) Analysis.

(i) Section 1245 gain. Under section 8.05(1) of this notice, for purposes of applying § 1245(a)(1), the recomputed basis of Factory A's disqualified property equals \$4,000,000 (the \$8,000,000 of the eligible property's unadjusted depreciable basis designated as QPP by Factory A, multiplied by 50 percent, which is the percentage of the eligible property that underwent a change in use, calculated based on Company A's reasonable determination that 25,000 square feet of Factory A underwent a change in use). Under section 8.02 of this notice, Company A is treated as disposing of the portion of Factory A that is disqualified property and recognizes a gain of \$4,000,000 in the 2032 taxable year which is treated as ordinary income.

(ii) Basis of disqualified property. Under section 8.03 of this notice, the disqualified property in Factory A is treated as a new, separate asset, and Company A's adjusted basis of \$0 in the disqualified property is increased by \$4,000,000 as of January 1, 2032, for purposes of determining the depreciation allowance for the disqualified property starting in the 2032 taxable year.

(iii) Depreciation allowances for disqualified property. Under section 8.04 of this notice, Company A determines its depreciation allowance for the disqualified property in the year of change and all subsequent taxable years by treating the disqualified property as placed in service on the first day of the year of change, taking into account the applicable convention. As the disqualified property is nonresidential real property, the depreciation allowance is determined using the straight line method under § 168(b)(3) and the mid-month convention under § 168(d)(2). Accordingly, for the

2032 taxable year, Company A has a depreciation allowance of \$98,291, equal to the unadjusted basis of \$4,000,000 divided by 39 years, times 11.5 divided by 12 months.

(iv) Depreciation allowances for portion(s) of property not designated as QPP.

Under section 8.01(1)(a) of this notice, the rules in section 8 of this notice do not apply to the portion(s) of Factory A not designated as QPP (undesignated property).

Therefore, the undesignated property is not treated as undergoing a QPP change in use, even though Company A began using part or all of the undesignated property in another productive use. Instead, the undesignated property continues to be depreciated using the applicable depreciation method, recovery period, and convention.

.08 Change in use by a transferee following a fully or partially tax-free transfer of QPP. For purposes of applying this section 8 to a change in use by a transferee following a fully or partially tax-free transfer of QPP, a taxpayer applies rules consistent with §§ 1.1245-2(a)(4) and (c)(2), and 1.1245-4(c).

SECTION 9. APPLICABILITY DATE AND RELIANCE

It is anticipated that the forthcoming proposed regulations will provide that rules consistent with the interim guidance provided in sections 3 through 8 of this notice apply to property the construction of which begins after January 19, 2025 (or, in the case of property described in section 4.06 of this notice, that is acquired after January 19, 2025), and which is placed in service in a taxable year beginning on or after the date the final § 168(n) regulations are published in the *Federal Register*. For property the construction of which begins after January 19, 2025 (or, in the case of property described in section 4.06 of this notice, that is acquired after January 19, 2025), and is placed in service in a taxable year beginning before the date the forthcoming proposed

regulations are published in the *Federal Register* or other published guidance is issued, a taxpayer may rely on the guidance provided in sections 3 through 8 of this notice, provided that the taxpayer follows the guidance provided in sections 3 through 8 of this notice in its entirety for all QPP placed in service in such taxable years, beginning with the first taxable year with respect to which the taxpayer relies on the guidance provided in sections 3 through 8 of this notice.

SECTION 10. REQUEST FOR COMMENTS

.01 Comments regarding guidance provided in this notice. The Treasury Department and the IRS request comments on questions arising from the interim guidance set forth in this notice. Commenters are encouraged to specify the issues on which additional guidance is needed in the forthcoming proposed regulations. In addition to general comments regarding the provisions of this notice, the Treasury Department and the IRS request comments to address the following specific questions:

(1) Allocation of basis to eligible property (section 4.08 of this notice). What are some other examples of reasonable methods to allocate a property's basis between eligible property and ineligible property?

(2) Manufacturing, chemical production, agricultural production, or refining (section 5 of this notice). Are the definitions for manufacturing, chemical production, agricultural production, and refining representative of their respective industries? Should the definitions, or the examples, in section 5 of this notice be expanded to include additional activities or examples, and if so, which activities or examples?

(3) Examples of substantial transformation of property (section 5.02(9) of this notice). What other examples of activities that are, or are not, manufacturing,

production, or refining that result in substantial transformation of property comprising a qualified product would be helpful to include in the forthcoming proposed regulations?

.02 Procedures for submitting comments.

(1) Deadline. Written comments should be submitted by April 20, 2026.

Consideration will be given, however, to any written comment submitted after April 20, 2026, if such consideration will not delay the issuance of forthcoming proposed regulations.

(2) Form and manner. The subject line for the comments should include a reference to Notice 2026-16. All commenters are strongly encouraged to submit comments electronically. However, comments may be submitted in one of two ways:

(a) Electronically via the Federal eRulemaking Portal at www.regulations.gov (type IRS-2026-**0016** in the search field on the regulations.gov homepage to find this notice and submit comments); or

(b) By mail to: Internal Revenue Service, CC:PA:LPD:PR (Notice 2026-16), Room 5203, P.O. Box 7604, Ben Franklin Station, Washington, D.C., 20044.

(3) Publication of comments. The Treasury Department and the IRS will publish for public availability any comment submitted electronically and on paper to its public docket on regulations.gov.

SECTION 11. PAPERWORK REDUCTION ACT

The Paperwork Reduction Act of 1995 (44 U.S.C. 3501-3520) (PRA) generally requires that a Federal agency obtain the approval of the Office of Management and Budget (OMB) before collecting information from the public, whether such collection of information is mandatory, voluntary, or required to obtain or retain a benefit. 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 OMB.

The collections of information in this revenue procedure are in section 7. These collections of information include recordkeeping requirements that are necessary to determine whether a taxpayer properly elected to claim the special depreciation allowance for QPP under § 168(n), properly designated the property subject to the election, and the amount of the allowance. These collections will be used by the IRS for tax compliance purposes and by taxpayers to calculate their deduction.

These collection requirements will be included in the OMB Control Number 1545-0074 for individual filers, 1545-0123 for business filers, 1545-0092 for trust and estate filers, and 1545-0047 for tax-exempt filers, in accordance with the PRA (44 U.S.C. 3507).

SECTION 12. DRAFTING AND CONTACT INFORMATION

The principal author of this notice is Jeremy Pfeifer of the Office of the Associate Chief Counsel (Income Tax and Accounting). However, additional personnel in the Office of Chief Counsel and at the Treasury Department participated in the development of this notice. For further information, please contact the Office of Associate Chief Counsel (Income Tax and Accounting), Branch 7, at (202) 317-7005 (not a toll-free number).