end of 1995 continue after 1995. The accumulated production expenditures for each partially completed condominium unit continue to include the costs of the condominium (including pool attributable land costs) in addition to the costs of an allocable share of the completed swimming pool (including attributable land costs).

Example 6. Assume the same facts as in Example 5, except that the swimming pool is only partially complete as of the end of 1995. Under these facts, X capitalizes no interest during 1996 for the 1 unit that includes the condominium sold during 1995 (including the costs of the allocable share of the swimming pool). See paragraph (b)(5)(i) of this section. However, with respect to the 6 condominiums that are partially complete and the 3 condominiums that are completed but unsold, interest capitalization continues after the end of 1995. The accumulated production expenditures for each of these 9 units include the costs of an allocable share of the swimming pool. See paragraph (b)(5)(i) of this section. In determining the costs of an allocable share of the swimming pool included in the accumulated production expenditures for each of the 9 units, X includes all costs of the swimming pool properly allocable to each unit, including those cost incurred after the date of the sale of unit 1 that may have been used under applicable administrative procedures (e.g., Rev. Proc. 92–29, 1992–1 C.B. 748) in determining the basis of unit 1 solely for purposes of computing gain or loss on the sale of unit 1. See §601.601(d)(2)(ii)(b) of this chapter.

Example 7. (i) Assume the same facts as in Example 5, except that X intends to lease rather than sell the condominiums and the completed swimming pool is placed in service for depreciation purposes on December 31, 1995. Additionally, assume that all 10 condominiums are partially completed at the end of 1995.

(ii) Under these facts, because the swimming pool is a common feature that is placed in service separately from the condominiums that it benefits, under paragraph (b)(5)(ii) of this section, the accumulated production expenditures of the condominium units do not include the costs of the allocable share of the swimming pool after 1995.

(c) Units of tangible personal property.

Components of tangible personal property are a single unit of property if the components are functionally interdependent. Components of tangible personal property that are produced by, or for, the taxpayer, for use by the taxpayer or a related person, are functionally interdependent if the placing in service of one component is dependent on the placing in service of the other component by the taxpayer or a related person. In the case of tangible personal property produced for sale, components of tangible personal property are functionally interdependent if they are customarily sold as a single unit. For example, if an aircraft manufacturer customarily sells completely assembled aircraft, the unit of property includes all components of a completely assembled aircraft. If the manufacturer also customarily sells aircraft engines separately, any engines that are reasonably expected to be sold separately are treated as single units of property.

(d) Treatment of installations. If the taxpayer produces or is treated as producing any property that is installed on or in other property, the production activity and installation activity relating to each unit of property generally are not aggregated for purposes of this section. However, if the taxpayer is treated as producing and installing any property for use by the taxpayer or a related person or if the taxpayer enters into a contract requiring the taxpayer to install property for use by a customer, the production activity and installation activity are aggregated for purposes of this section.

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taken into account under the taxpayer’s method of accounting (e.g.,
after applying the requirements of section 461, including the economic per-
formance requirement of section 461(h)). Costs that have been incurred
and capitalized with respect to a unit of property prior to the beginning of
the production period are taken into account as accumulated production ex-
penditures beginning on the date on which the production period of the
property begins (as defined in §1.263A-12(c)). Thus, for example, the cost of
raw land acquired for development, the cost of a leasehold in mineral prop-
erties acquired for development, and the capitalized cost of planning and de-
sign activities are taken into account as accumulated production expendi-
tures beginning on the first day of the production period. For purposes of de-
termining accumulated production expenditures on any measurement date
during a computation period, the interest required to be capitalized for the
computation period is deemed to be capitalized on the day immediately fol-
lowing the end of the computation pe-
riod. For any subsequent measurement dates and computation periods, that in-
terest is included in accumulated pro-
duction expenditures. If the cost of
land or common features is allocated
among planned units of property that
are completed in phases, any portion of
the cost properly allocated to com-
pleted units is not reallocated to any
incomplete units of property.

(2) Dedication rule for materials and
supplies. The costs of raw materials,
supplies, or similar items are taken
into account as accumulated produc-
tion expenditures when they are in-
curred and dedicated to production of a
unit of property. Dedicated means the
first date on which the raw materials,
supplies, or similar items are specifi-
cally associated with the production of
any unit of property, including by record, assignment to the specific job
site, or physical incorporation. In con-
trast, in the case of a component or subassembly that is reasonably ex-
pected to be become a part of (e.g., be incorporated into) any unit of prop-
erty, costs incurred (including dedi-
cated raw materials) for the component
or subassembly are taken into account
as accumulated production expendi-
tures during the production of any por-
tion of the component or subassembly
and prior to its connection with (e.g.,
incorporation into) any specific unit of
property. For purposes of the preceding sentence, components and subas-
semblies must be aggregated at each meas-
urement date in a reasonable manner
that is consistent with the purposes of
section 263A(f).

(c) Property produced under a con-
tract—(1) Customer. If a unit of property
produced under a contract is des-
ignated property under §1.263A-
8(d)(2)(i) with respect to the customer,
the customer’s accumulated production expenditures include any payments
under the contract that represent part
of the purchase price of the unit of des-
ignated property or, to the extent costs
are incurred earlier than payments are
made (determined on a cumulative basis for each unit of designated prop-
erty), any part of such price for which
the requirements of section 461 have
been satisfied. The customer has made
a payment under this section if the
transaction would be considered a pay-
ment by a taxpayer using the cash re-
cceipts and disbursements method of ac-
counting. The customer’s accumulated
production expenditures also include
any other costs incurred by the cus-
tomer, such as interest, or any other
direct or indirect costs that are re-
quired to be capitalized under section
263A(a) and the regulations thereunder
with respect to the production of the
unit of designated property.

(2) Contractor. If a unit of property
produced under a contract is des-
ignated property under §1.263A-
8(d)(2)(i) with respect to the con-
tractor, the contractor must treat the
cumulative amount of payments made
by the customer under the contract at-
tributable to the unit of property as a
reduction in the contractor’s accumu-
lated production expenditures. The cus-
tomer has made a payment under this
section if the transaction would be con-
sidered a payment by a taxpayer using
the cash receipts and disbursements
method of accounting.

(d) Property used to produce designated
property—(1) In general. Accumulated
production expenditures include the
adjusted bases (or portion thereof) of
any equipment, facilities, or other similar assets, used in a reasonably proximate manner for the production of a unit of designated property during any measurement period in which the asset is so used. Examples of assets used in a reasonably proximate manner include machinery and equipment used directly or indirectly in the production process, such as assembly-line structures, cranes, bulldozers, and buildings. A taxpayer apportions the adjusted basis of an asset used in the production of more than one unit of designated property in a measurement period among such units of designated property using reasonable criteria corresponding to the use of the asset, such as machine hours, mileage, or units of production. If an asset used in a reasonably proximate manner for the production of a unit of designated property is temporarily idle (within the meaning of §1.263A–1(e)(3)(iii)(E)) for an entire measurement period, the adjusted basis of the asset is excluded from the accumulated production expenditures for the unit during that measurement period. Notwithstanding this paragraph (d)(1), the portion of the depreciation allowance for equipment, facilities, or any other asset that is capitalized with respect to a unit of designated property in accordance with §1.263A–1(e)(3)(ii)(I) is included in accumulated production expenditures with respect to the improvement consist of—

(3) Excluded equipment and facilities. The adjusted bases of equipment, facilities, or other assets that are not used in a reasonably proximate manner to produce a unit of property are not included in the computation of accumulated production expenditures. For example, the adjusted bases of equipment and facilities, including buildings and other structures, used in service departments performing administrative, purchasing, personnel, legal, accounting, or similar functions, are excluded from the computation of accumulated production expenditures under this paragraph (d)(3).

(e) Improvements—(1) General rule. If an improvement constitutes the production of designated property under §1.263A–8(d)(3), accumulated production expenditures with respect to the improvement consist of—

(i) All direct and indirect costs required to be capitalized with respect to the improvement,

(ii) In the case of an improvement to a unit of real property—

(A) An allocable portion of the cost of land, and

(B) For any measurement period, the adjusted basis of any existing structure, common feature, or other property that is not placed in service or must be temporarily withdrawn from service to complete the improvement (associated property) during any part of the measurement period if the associated property directly benefits the property being improved, the associated property directly benefits from the improvement, or the improvement was incurred by reason of the associated property. See, however, the de minimis rule under paragraph (e)(2) of this section that applies in the case of associated property.

(iii) In the case of an improvement to a unit of tangible personal property, the adjusted basis of the asset being improved if that asset either is not
§ 1.263A-12 Production period.

(a) In general. Capitalization of interest is required under §1.263A-9 for computation periods (within the meaning of §1.263A-9(f)(1)) that include the production period of a unit of designated property. In contrast, section 263A(a) requires the capitalization of all other direct or indirect costs, such as insurance, taxes, and storage, that directly benefit or are incurred by reason of the production of property without regard to whether they are incurred during a period in which production activity occurs.

(b) Related person activities. Activities performed and costs incurred by a person related to the taxpayer that directly benefit or are incurred by reason of the taxpayer’s production of designated property are taken into account in determining the taxpayer’s production period (regardless of whether the related person is performing only a service or is producing a sub-assembly or component that the related person is required to treat as an item of designated property). These activities and the related person’s costs are also taken into account in determining whether tangible personal property produced by the taxpayer is 1-year or 2-year property under §1.263A-8(b)(1)(i)(B) and (C).

(c) Beginning of production period—(1) In general. A separate production period is determined for each unit of property defined in §1.263A-10. The production period begins on the date that production of the unit of property begins.

(2) Real property. The production period of a unit of real property begins on the first date that any physical production activity (as defined in paragraph (e) of this section) is performed with respect to a unit of real property. See §1.263A-10(b)(1). The production period of a unit of real property produced under a contract begins for the contractor on the date the contractor begins physical production activity on the property. The production period of a unit of real property produced under

placed in service or must be temporarily withdrawn from service to complete the improvement.

(2) De minimis rule. For purposes of paragraph (e)(1)(ii) of this section, the total costs of all associated property for an improvement unit (associated property costs) are excluded from the accumulated production expenditures for the improvement unit during its production period if, on the date the production period of the unit begins, the taxpayer reasonably expects that at no time during the production period of the unit will the accumulated production expenditures for the unit, determined without regard to the associated property costs, exceed 5 percent of the associated property costs.

(f) Mid-production purchases. If a taxpayer purchases a unit of property for further production, the taxpayer’s accumulated production expenditures include the full purchase price of the property plus, in accordance with the principles of paragraph (e) of this section, additional direct and indirect costs incurred by the taxpayer.

(g) Related person costs. The activities of a related person are taken into account in applying the classification thresholds under §1.263A-8(b)(1)(i)(B) and (C), and in determining the production period of a unit of designated property under §1.263A-12. However, only those costs incurred by the taxpayer are taken into account in the taxpayer’s accumulated production expenditures under this section because the related person includes its own capitalized costs in the related person’s accumulated production expenditures with respect to any unit of designated property upon which the parties engage in mutual production activities. For purposes of the preceding sentence, the accumulated production expenditures of any property transferred to a taxpayer in a nontaxable transaction are treated as accumulated production expenditures incurred by the taxpayer.

(h) Installation. If the taxpayer installs property that is purchased by the taxpayer, accumulated production expenditures include the cost of the property that is installed in addition to the direct and indirect costs of installation.