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(8) Certain benefits arising from  tion, or improvement of real property--

Find § in Tax Practice 

(i) In general.

A taxpayer must capitalize amounts paid for real property if the taxpayer transfers ownership of the real property to another person (except to the extent the real property is sold for fair market value) and if the real property can reasonably be expected to produce significant economic benefits to the taxpayer after the transfer. A taxpayer also must capitalize amounts paid to produce or improve real property owned by another (except to the extent the taxpayer is selling services at fair market value to produce or improve the real property) if the real property can reasonably be expected to produce significant economic benefits for the taxpayer.

(ii) Exclusions.

A taxpayer is not required to capitalize an amount under paragraph (d)(8)(i) of this section if the taxpayer transfers real property or pays an amount to produce or improve real property owned by another in exchange for services, the purchase or use of property, or the creation of an intangible described in paragraph (d) of this section (other than in this paragraph (d)(8)). The preceding sentence does not apply to the extent the taxpayer does not receive fair market value consideration for the real property that is relinquished or for the amounts that are paid by the taxpayer to produce or improve real property owned by another.

(iii) Real property.

For purposes of this paragraph (d)(8), real property includes property that is affixed to real property and that will ordinarily remain affixed for an indefinite period of time, such as roads, bridges, tunnels, pavements, wharves and docks, breakwaters and sea walls, elevators, power generation and transmission facilities, and pollution control facilities.

(iv) Impact fees and dedicated improvements.

Paragraph (d)(8)(i) of this section does not apply to amounts paid to satisfy one-time charges imposed by a state or local government against new development (or expansion of existing development) to finance specific offsite capital improvements for general public use that are necessitated by the new or expanded development. In addition, paragraph (d)(8)(i) of this section does not apply to amounts paid for real property or improvements to real property constructed by the taxpayer where the real property or improvements benefit new development or expansion of existing development, are immediately transferred to a state or local

government for dedication to the general public use, and are maintained by the state or local government. See section 263A and the regulations thereunder for capitalization rules that apply to amounts referred to in this paragraph (d)(8)(iv).

(v) Examples.

The following examples illustrate the rules of this paragraph (d)(8):

Example 1.

Amount paid to produce real property owned by another.

W corporation operates a quarry on the east side of a river in city Z and a crusher on the west side of the river. City Z's existing bridges are of insufficient capacity to be traveled by trucks in transferring stone from W's quarry to its crusher. As a result, the efficiency of W's operations is greatly reduced. W contributes \$1,000,000 to City Z to defray in part the cost of constructing a publicly owned bridge capable of accommodating W's trucks. W's payment to city Z is an amount paid to produce or improve real property (within the meaning of paragraph (d)(8)(iii) of this section) that can reasonably be expected to produce significant economic benefits for W. Under paragraph (d)(8)(i) of this section, W must capitalize the \$1,000,000 paid to city Z.

Example 2.

Transfer of real property to another.

K corporation, a shipping company, uses smaller vessels to unload its ocean-going vessels at port X. There is no natural harbor at port X, and during stormy weather the transfer of freight between K's ocean vessels and port X is extremely difficult and sometimes impossible, which can be very costly to K. Consequently, K constructs a short breakwater at a cost of \$50,000. The short breakwater, however, is inadequate, so K persuades the port authority to build a larger breakwater that will allow K to unload its vessels at any time of the year and during all kinds of weather. K contributes the short breakwater and pays \$200,000 to the port authority for use in building the larger breakwater. Because the transfer of the small breakwater and \$200,000 is reasonably expected to produce significant economic benefits for K, K must capitalize both the adjusted basis of the small breakwater (determined at the time the small breakwater is contributed) and the \$200,000 payment under this paragraph (d)(8).

Example 3.

Dedicated improvements.

X corporation is engaged in the development and sale of residential real estate. In connection with a residential real estate project under construction by X in city Z, X is required by city Z to construct ingress and egress roads to and from its project and immediately transfer the roads to city Z for dedication to general public use. The roads will be maintained by city Z. X pays its subcontractor \$100,000 to construct the ingress and egress roads. X's payment is a dedicated improvement within the meaning of paragraph (d)(8)(iv) of this section. Accordingly, X is not required to capitalize the \$100,000 payment under this paragraph (d)(8). See section 263A and the regulations thereunder for capitalization rules that apply to amounts referred to in paragraph (d)(8)(iv) of this section.