

Insights

Treasury and IRS Issue Interim Guidance on 100% Depreciation for Qualified Production Property

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On February 20, 2026, the U.S. Department of the Treasury and the Internal Revenue Service released Notice 2026-16, providing interim guidance on a new 100% special depreciation allowance for certain nonresidential real property, depreciable under MACRS,¹ used in manufacturing and other production activities. The guidance implements a provision enacted under the One, Big, Beautiful Bill Act (OBBBA) and allows eligible taxpayers to immediately deduct up to 100% of the unadjusted depreciable basis of qualifying production facilities placed in service between July 4, 2025, and January 1, 2031. Treasury and the IRS also announced that proposed regulations are forthcoming and invited public comments on the interim rules.

Background and Legislative Context

The special depreciation allowance addressed in Notice 2026-16 originates in section 70307 of the OBBBA, enacted on July 4, 2025. That legislation amended Internal Revenue Code section 168 to add new subsection (n), creating a temporary incentive designed to encourage domestic manufacturing, refining, agricultural production, and chemical production.

Under prior law, nonresidential real property generally was depreciated over 39 years using the straight-line method. The OBBBA significantly altered that framework for a defined class of production facilities by permitting taxpayers, through an affirmative election, to expense up to the full depreciable basis of qualifying property in the year it is placed in service. Notice 2026-16 fills an important gap by providing detailed definitions, eligibility rules, election mechanics, and recapture provisions pending the issuance of proposed regulations.

Taxpayers may rely on the interim guidance until those proposed regulations are issued, provided they apply the notice consistently.

Overview of Notice 2026-16

Qualified Production Property

To qualify for the special depreciation allowance, property must meet a detailed set of requirements. In general, qualified production property (QPP) is nonresidential real property that is depreciable under MACRS, used as an integral part of a qualified production activity, located in the United States or a U.S. territory, and placed in service after July 4, 2025, and before January 1, 2031. Portions of property used for offices, administrative services, parking, lodging, sales, research, software development, or other non-production activities are excluded. Although leased property generally does not qualify, the notice includes exceptions for certain consolidated group and commonly controlled leasing arrangements, which may be relevant to affiliated

real estate and operating structures.

Qualified Production Activities

A qualified production activity includes manufacturing, production, or refining activities that result in a substantial transformation of tangible personal property. For property placed in service after July 4, 2025, and on or before December 31, 2025, the notice also provides a safe harbor allowing certain taxpayers to rely on applicable NAICS manufacturing or agricultural codes to establish a qualified production activity. The notice provides detailed examples and clarifications, including safe harbors for certain activities and property placed in service during 2025.

Election Mechanics and Timing

The special depreciation allowance is elective and must be claimed on a property-by-property basis. The election is made on a timely filed original federal income tax return for the year the property is placed in service and generally is irrevocable. The notice also provides an automatic one-year extension of the placed-in-service deadline for certain property located in federally declared disaster areas.

Depreciation Recapture

If property ceases to be used as an integral part of a qualified production activity within 10 years after being placed in service, recapture rules may apply, leading to recognition of ordinary income for the amount recaptured.

Practical Implications and Recommended Actions

Initial Questions to Consider Under Notice 2026-16

- 1. Project timing:** Do you have a nonresidential real property project (including expansions or capitalized improvements) for which construction began after January 19, 2025, and that will be placed in service between July 4, 2025, and January 1, 2031?
- 2. Production activity:** Are the activities conducted in the facility properly characterized as manufacturing, production, refining, agricultural production, or chemical production involving a substantial transformation of tangible personal property?
- 3. Facility use and allocation:** Does the facility include mixed-use space (e.g., offices, R&D, finished-goods storage), and do you have supportable documentation to allocate basis between qualifying and non-qualifying portions?
- 4. Election mechanics:** Are you prepared to make the section 168(n) election on a timely filed original return, and should you designate all or only a portion of the eligible basis as qualified production property?
- 5. Change-in-use risk:** Is there a reasonable possibility that all or part of the facility could be repurposed within 10 years, potentially triggering depreciation recapture?

Notice 2026-16 presents a meaningful opportunity for manufacturers and other production-oriented businesses to accelerate cost recovery for new and expanded facilities, but eligibility depends on detailed and highly fact-specific rules. Taxpayers should review current and planned construction projects (including expansions and capitalized improvements) to determine whether they may qualify as qualified production property. In many cases, eligibility will turn on how space within a facility is used and documented, requiring careful allocation between production and non-production areas and coordination with engineering or facilities teams.

Because the election to claim the special depreciation allowance generally must be made on a timely filed original return and is difficult to revoke, taxpayers should also consider the broader tax impact and any potential recapture exposure if a facility's use may change within the next 10 years. Businesses with significant capital projects or unique production activities may also wish to monitor, or participate in, the regulatory process, as Treasury and the IRS have requested comments on the interim guidance by April 20, 2026.

Krieg DeVault's attorneys will continue to monitor developments relating to Notice 2026-16, including the issuance of proposed regulations under section 168(n) and any additional guidance from the Treasury Department or the Internal Revenue Service addressing qualified production property, election mechanics, and depreciation recapture. Manufacturers and other affected businesses with questions regarding potential eligibility, election timing, documentation considerations, or the impact of the special depreciation allowance on current or planned projects are encouraged to contact Kendall A. Schnurpel or their regular Krieg DeVault attorney.

¹MACRS is the federal tax depreciation system under Section 168 of the Internal Revenue Code that generally determines how and over what period businesses recover the cost of depreciable property.

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