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[4830-01-p]

DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Part 1

[TD 9689]

RIN 1545-BL52

Guidance Regarding Dispositions of Tangible Depreciable Property

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations and removal of temporary regulations.

SUMMARY: This document contains final regulations regarding dispositions of property subject to depreciation under section 168 of the Internal Revenue Code (Code) (Modified Accelerated Cost Recovery System (MACRS) property). The final regulations also amend the general asset account regulations and the accounting for MACRS property regulations. The final regulations provide rules for determining gain or loss upon the disposition of MACRS property, determining the asset disposed of, and accounting for partial dispositions of MACRS property. The final regulations affect taxpayers that dispose of MACRS property. The final regulations also remove temporary regulations under section 168 regarding general asset accounts and disposition of MACRS property.

DATES: Effective Date: These regulations are effective on **[INSERT DATE OF PUBLICATION IN THE FEDERAL REGISTER]**.

Applicability Dates: These regulations apply to taxable years beginning on or after January 1, 2014. For dates of applicability of the final regulations, see §§1.168(i)-1(m), 1.168(i)-7(e), and 1.168(i)-8(j).

FOR FURTHER INFORMATION CONTACT: Kathleen Reed or Patrick Clinton, Office of Associate Chief Counsel (Income Tax and Accounting), (202) 317-7005 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

### **Background**

On December 27, 2011, the IRS and the Treasury Department published in the **Federal Register** (76 FR 81060) temporary regulations (TD 9564) regarding the accounting for, and dispositions of, property subject to depreciation under section 168 (MACRS property). The temporary regulations also amended the general asset account regulations under §1.168(i)-1. On the same date, the IRS published in the **Federal Register** (76 FR 81128) a notice of proposed rulemaking (REG-168745-03) cross-referencing the temporary regulations (2011 proposed regulations). The IRS and the Treasury Department received numerous written comments responding to the 2011 proposed regulations and held a public hearing on May 9, 2012.

The temporary regulations initially applied to taxable years beginning on or after January 1, 2012. In response to the comments received and the statements made at the public hearing, the IRS and the Treasury Department released Notice 2012-73, 2012-51 IRB 713, on November 20, 2012, announcing that, to help taxpayers transition to the final regulations, the IRS and the Treasury Department would change the applicability date of the temporary regulations to taxable years beginning on or after

January 1, 2014, while permitting taxpayers to choose to apply the temporary regulations to taxable years beginning on or after January 1, 2012, and before the applicability date of the final regulations. Notice 2012-73 also alerted taxpayers that the IRS and the Treasury Department intended to publish final regulations in 2013 and expected the final regulations to apply to taxable years beginning on or after January 1, 2014, but that the final regulations would permit taxpayers to apply the provisions of the final regulations to taxable years beginning on or after January 1, 2012. On December 17, 2012, the IRS and the Treasury Department published in the **Federal Register** (77 FR 74583) a technical amendment to TD 9564, which amended the applicability date of the temporary regulations to taxable years beginning on or after January 1, 2014, while permitting taxpayers to choose to apply the temporary regulations to taxable years beginning on or after January 1, 2012, and before the applicability date of the final regulations.

Notice 2012-73 also alerted taxpayers that the IRS and the Treasury Department intended to revise the disposition rules in the temporary regulations. After considering the comment letters and the statements made at the public hearing, the IRS and the Treasury Department removed the temporary regulations under section 167 and §1.168(i)-7 and issued final regulations in the **Federal Register** on September 19, 2013 (78 FR 57686). The final regulations under section 167 provide rules for depreciation of leasehold improvements and amend existing regulations under section 167 regarding accounting for and retirement of depreciable property. Section 1.168(i)-7 provides rules for how to account for MACRS property. On the same date, the IRS also withdrew the 2011 proposed regulations under §§1.168(i)-1 and 1.168(i)-8 and published a notice of

proposed rulemaking (REG-110732-13) under §§1.168(i)-1, 1.168(i)-7, and 1.168(i)-8 (2013 proposed regulations) in the **Federal Register** (78 FR 57547). The 2011 proposed regulations under §1.168(i)-1 amended the existing regulations on general asset accounts, and the 2011 proposed regulations under §1.168(i)-8 provided rules for dispositions of MACRS property. The IRS and the Treasury Department did not withdraw or remove the temporary regulations under §§1.168(i)-1T and 1.168(i)-8T and taxpayers continued to have the option of applying those temporary regulations to taxable years beginning on or after January 1, 2012, and before the applicability date of the final regulations.

No comments were received from the public in response to the 2013 proposed regulations. No public hearing was requested or held. However, the IRS and the Treasury Department are making clarifying changes to the 2013 proposed regulations regarding the determination of the unadjusted depreciable basis of a disposed asset in a general or multiple asset account or a disposed portion of an asset, and the manner of making certain disposition elections for assets included in a general asset account when section 280B applies. These revisions are discussed in this preamble. The IRS and the Treasury Department are removing the temporary regulations under §§1.168(i)-1T and 1.168(i)-8T and are issuing final regulations under §§1.168(i)-1, 1.168(i)-7, and 1.168(i)-8. The 2013 proposed regulations are adopted as amended by this Treasury decision.

## **Explanation of Provisions and Revisions**

### **I. Overview**

The final regulations under §§1.168(i)-1, 1.168(i)-7, and 1.168(i)-8 generally retain all of the provisions of the 2013 proposed regulations. Section 1.168(i)-1 amends

the existing general asset account regulations regarding establishment of general asset accounts, depreciation of a general asset account, and dispositions of assets in a general asset account. Section 1.168(i)-7 amends the existing regulations on accounting for MACRS property to address partial dispositions of MACRS property. Section 1.168(i)-8 provides rules for dispositions of MACRS property. These final regulations generally apply to taxable years beginning on or after January 1, 2014.

## II. Disposition Rules for MACRS Property Under §1.168(i)-8

Section 1.168(i)-8 provides the basic rules applicable to dispositions of MACRS property, and §1.168(i)-1 provides special rules applicable to MACRS property included in a general asset account.

### A. Definition of disposition

The final regulations retain the definition of “disposition” for MACRS property that is set forth in the 2013 proposed regulations. A disposition occurs when ownership of the asset is transferred or when the asset is permanently withdrawn from use either in the taxpayer’s trade or business or in the production of income. A disposition includes the sale, exchange, retirement, physical abandonment, or destruction of an asset. A disposition also includes the retirement of a structural component (or a portion thereof) of a building only if the partial disposition rule (discussed in II.C) applies to such structural component (or a portion thereof). Finally, the manner of disposition (for example, abnormal retirement or normal retirement) is not taken into consideration in determining whether a disposition occurs or gain or loss is recognized.

### B. Determining appropriate disposed asset

The final regulations also retain the rules in the 2013 proposed regulations for determining the disposed asset for tax disposition purposes. In general, the facts and

circumstances of each disposition are considered in determining the appropriate disposed asset. However and as provided in the 2013 proposed regulations, the asset for tax disposition purposes may not consist of items placed in service by the taxpayer on different dates (without taking into account the applicable convention). Further, the unit of property as determined under §1.263(a)-3(e) or in published guidance in the Internal Revenue Bulletin under section 263(a) does not apply for purposes of determining what is the appropriate disposed asset.

In addition to these general rules, the final regulations provide special rules for certain types of properties. The final regulations retain the rule in the 2013 proposed regulations that each building (including its structural components) is the asset for tax disposition purposes, unless more than one building (including its structural components) is treated as the asset under §1.1250-1(a)(2)(ii), there is an improvement or addition to an existing building (including its structural components), or the building includes two or more condominium or cooperative units. If there is an improvement or addition to an existing building (including its structural components), the improvement or addition is the asset. If a building includes two or more condominium or cooperative units, each condominium or cooperative unit (including its structural components) is the asset.

The final regulations also provide that if a taxpayer properly includes an item in one of the asset classes 00.11 through 00.4 of Rev. Proc. 87-56 (1987-2 CB 674) or classifies an item in one of the categories under section 168(e)(3) (other than a category that includes buildings or structural components; for example, retail motor fuels

outlet and qualified leasehold improvement property), each item is the asset provided it is not an improvement or addition to an existing asset.

Finally, and consistent with section 168(i)(6), the final regulations provide that 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 is a separate asset.

### C. Partial dispositions

The final regulations also retain the partial disposition rule in the 2013 proposed regulations. Consequently, the disposition rules in the final regulations apply to a partial disposition of an asset (for example, the disposition of a roof (or a portion of a roof)). The partial disposition rule allows taxpayers to claim a loss upon the disposition of a structural component (or a portion thereof) of a building or upon the disposition of a component (or a portion thereof) of any other asset without identifying the component as an asset before the disposition event. The partial disposition rule also minimizes circumstances in which an original part and any subsequent replacements of the same part are required to be capitalized and depreciated simultaneously. These final regulations provide examples demonstrating the application of the partial disposition rule.

In many cases, the partial disposition rule is elective (“partial disposition election”). However, consistent with the 2013 proposed regulations and the operation of sections 165, 168(i)(7), 1031, and 1033, and because sales of a portion of an asset are common, the partial disposition rule is required to be applied to a disposition of a portion of an asset as a result of a casualty event described in section 165, to a disposition of a portion of an asset for which gain (determined without regard to section 1245 or 1250) is

not recognized in whole or in part under section 1031 or 1033, to a transfer of a portion of an asset in a step-in-the-shoes transaction described in section 168(i)(7)(B), or to a sale of a portion of an asset. Consequently, a disposition includes a disposition of a portion of an asset under these circumstances, even if the taxpayer does not make the partial disposition election for that disposed portion. For other transactions, a disposition includes a disposition of a portion of an asset only if the taxpayer makes the partial disposition election for that disposed portion.

A taxpayer may make the partial disposition election for the disposition of a portion of any type of MACRS property, including an asset that is properly included in one of the asset classes 00.11 through 00.4 of Rev. Proc. 87-56. However, consistent with section 168(i)(6) and the 2013 proposed regulations, a taxpayer making the partial disposition election for the disposition of a portion of an asset that is properly included in one of the asset classes 00.11 through 00.4 of Rev. Proc. 87-56 must classify the replacement portion of the asset under the same asset class as the disposed portion of the asset.

The partial disposition election is made on the taxpayer's timely filed original Federal tax return, including extensions, for the taxable year in which the portion of the asset is disposed of by the taxpayer. This election may not be made or revoked by the filing of an application for a change in method of accounting. A taxpayer may revoke a partial disposition election by filing a request for a letter ruling and obtaining the consent of the Commissioner of Internal Revenue to revoke this election. The Commissioner may grant a request to revoke this election if the taxpayer acted reasonably and in good faith, and the revocation will not prejudice the interests of the Government. In deciding

whether to grant such a request, the Commissioner anticipates applying standards similar to the standards under §301.9100-3 of this chapter for granting extensions of time for making regulatory elections. If a taxpayer chooses to apply these final regulations to its taxable year beginning in 2012 or 2013, these final regulations also provide rules for making the partial disposition election for the portion of an asset disposed of by the taxpayer during those taxable years.

The final regulations also provide a special partial disposition rule to address the effect of an IRS disallowance of a taxpayer's characterization of the replacement of a portion of an asset as a repair. When the IRS disallows a taxpayer's repair deduction for the amount paid or incurred for the replacement of a portion of an asset and capitalizes such amount under §1.263(a)-2 or §1.263(a)-3, the taxpayer may make the partial disposition election for the disposition of the portion of the asset to which the IRS's adjustment pertains by filing an application for change in accounting method, provided the asset of which the disposed portion was a part is owned by the taxpayer at the beginning of the year of change (as defined for purposes of section 446(e)).

#### D. Gain or loss

The final regulations also retain the rules in the 2013 proposed regulations for determining gain or loss upon the disposition of MACRS property. These rules are generally consistent with the disposition rules under §1.168-6 of the proposed regulations on the Accelerated Cost Recovery System of former section 168 (ACRS) (which generally have been applied to MACRS property). If an asset is disposed of by sale, exchange, or involuntary conversion, gain or loss is recognized under the applicable provisions of the Code. If an asset is disposed of by physical abandonment, loss is recognized in the amount of the asset's adjusted depreciable basis at the time of

the abandonment, unless an abandoned asset is subject to nonrecourse indebtedness in which case the asset is treated in the same manner as an asset disposed of by sale. Finally, if an asset is disposed of other than by sale, exchange, involuntary conversion, physical abandonment, or conversion to personal use (for example, when the asset is transferred to a supplies or scrap account), gain is not recognized but loss is recognized in the amount of the excess of the asset's adjusted depreciable basis over its fair market value at the time of disposition. The same rules apply when the partial disposition rule applies to a disposition of a portion of an asset.

E. Determination of basis of disposed asset

The final regulations retain the rule in the 2013 proposed regulations on determining the unadjusted depreciable basis of a disposed asset if that asset is in a multiple asset account and it is impracticable from the taxpayer's records to determine the unadjusted depreciable basis of the disposed asset. In such a situation, the final regulations provide that the taxpayer may use any reasonable method that is consistently applied to all assets in the same multiple asset account. The IRS and the Treasury Department expect that reasonable methods are available that use information readily available or known to the taxpayer and do not necessitate undertaking an expensive study.

These final regulations also provide nonexclusive examples of reasonable methods. These examples are the same examples in the 2013 proposed regulations, except that the final regulations do not include discounting the cost of the replacement asset by the Consumer Price Index as an example of a reasonable method. After further review, the IRS and the Treasury Department have determined that the Producer Price Index for Finished Goods (and its successor, the Producer Price Index for Final

Demand) more accurately reflects inflation for capital expenditures. The final regulations also clarify that discounting the cost of the replacement asset using the Producer Price Index for Finished Goods is a reasonable method only if the replacement asset is a restoration under §1.263(a)-3(k) and is not a betterment under §1.263(a)-3(j) or is not an adaptation to a new or different use under §1.263(a)-3(l). The examples in the final regulations include the following: (1) discounting the cost of the replacement asset to its placed-in-service year cost using the Producer Price Index for Finished Goods (or its successor, the Producer Price Index for Final Demand, or any other index designated by guidance in the Internal Revenue Bulletin (see §601.601(d)(2) of the chapter) for purposes of the final regulations) where the replacement asset is a restoration under §1.263(a)-3(k) and is not a betterment under §1.263(a)-3(j) or is not an adaptation to a new or different use under §1.263(a)-3(l); (2) a pro rata allocation of the unadjusted depreciable basis of the multiple asset account based on the replacement cost of the disposed asset and the replacement cost of all of the assets in the multiple asset account; and (3) a study allocating the cost of the asset to its individual components.

The final regulations also provide rules to determine the unadjusted depreciable basis of the disposed portion of an asset when the partial disposition rule applies. While these rules retain most of the rules in the 2013 proposed regulations, the final regulations were changed to clarify when a taxpayer may use a reasonable method for determining the unadjusted depreciable basis of a disposed portion of an asset. The IRS and the Treasury Department intended to allow taxpayers to use a reasonable method under the same circumstances as described above for determining the

unadjusted depreciable basis of a disposed asset in a multiple asset account. However, the 2013 proposed regulations did not reflect this intent. Consequently, the final regulations clarify that a taxpayer may use any reasonable method for determining the unadjusted depreciable basis of the disposed portion of the asset only if it is impracticable from the taxpayer's records to determine such unadjusted depreciable basis. If a taxpayer disposes of more than one portion of the same asset and it is impracticable from the taxpayer's records to determine the unadjusted depreciable basis of the first disposed portion of the asset, the reasonable method used by the taxpayer must be consistently applied to all portions of the same asset for purposes of determining the unadjusted depreciable basis of each disposed portion of the asset. If the asset, a portion of which is disposed of, is in a multiple asset account, the reasonable method used by the taxpayer must be consistently applied to all assets and portions of assets in the same multiple asset account. Finally, the final regulations provide nonexclusive examples of reasonable methods that are similar to those discussed in the preceding paragraph.

F. Identification of disposed asset

The final regulations retain the rules in the 2013 proposed regulations for determining the placed-in-service year of a disposed asset. In general, a taxpayer must use the specific identification method. Under this method, the taxpayer can determine when the asset disposed of was placed in service. If an asset is in a multiple asset account and it is impracticable from the taxpayer's records to determine the particular year in which the asset was placed in service by the taxpayer, the final regulations allow the taxpayer to identify the asset by using the following: a first-in, first-out (FIFO)

method, a modified FIFO method, a mortality dispersion table if the asset is a mass asset, or any other method designated by the Secretary in published guidance. A last-in, first-out (LIFO) method is not permitted. These rules also apply when the partial disposition rule applies to a disposition of a portion of an asset and it is impracticable from the taxpayer's records to determine the particular taxable year in which the asset was placed in service by the taxpayer. The final regulations provide an additional example of the LIFO method, which is impermissible.

### III. General Asset Accounts Under §1.168(i)-1

Section 168(i)(4) provides that, under regulations, a taxpayer may maintain one or more general asset accounts for any MACRS property. Except as provided in regulations, all proceeds realized on any disposition of property in a general asset account shall be included in income as ordinary income.

The final regulations generally retain all of the provisions in the 2013 proposed regulations for general asset accounts. The final regulations apply only to assets for which the taxpayer has made an election to account for the assets in general asset accounts. Each general asset account effectively is treated as the asset.

#### A. Establishing general asset accounts

The final regulations retain the rules in the 2013 proposed regulations for establishing general asset accounts. The final regulations provide that assets may be grouped into one or more general asset accounts. In general, each general asset account must include assets that have the same depreciation method, recovery period, and convention, and are placed in service in the same taxable year. However and as provided in the 2013 proposed regulations, the final regulations provide special rules in

certain circumstances for establishing general asset accounts. For example, assets eligible for the additional first year depreciation deduction cannot be grouped with assets ineligible for the additional first year depreciation deduction. Also, assets eligible for the additional first year depreciation deduction may be grouped only with assets eligible for the same percentage of the additional first year depreciation.

#### B. Depreciation of a general asset account

The final regulations retain the rules in the 2013 proposed regulations for determining depreciation for each general asset account. The final regulations explain how to determine depreciation for a general asset account when all the assets in the account are eligible for the additional first year depreciation deduction and when all the assets in the account are not eligible for that deduction.

#### C. Disposition of an asset from a general asset account

##### 1. Disposition Definition

The final regulations retain the definition of “disposition” that is set forth in the 2013 proposed regulations. This definition is the same as the definition of “disposition” that was previously discussed under the disposition rules for MACRS property under §1.168(i)-8. That is, a disposition occurs when ownership of the asset is transferred or when the asset is permanently withdrawn from use either in the taxpayer’s trade or business or in the production of income. A disposition includes the sale, exchange, retirement, physical abandonment, or destruction of an asset. A disposition also includes the retirement of a structural component (or a portion thereof) of a building only if the partial disposition rule (discussed in III.C.4) applies to such structural component (or a portion thereof). Finally, the manner of disposition (for example, abnormal

retirement or normal retirement) is not taken into consideration in determining whether a disposition occurs or gain or loss is recognized.

## 2. Determining the Appropriate Disposed Asset

The final regulations also retain the rules in the 2013 proposed regulations for determining the disposed asset included in a general asset account for tax disposition purposes. These rules are the same as those previously discussed for determining the disposed asset for purposes of §1.168(i)-8.

In general, the facts and circumstances of each disposition are considered in determining the appropriate disposed asset included in a general asset account. However, the asset for tax disposition purposes may not consist of items placed in service by the taxpayer on different dates (without taking into account the applicable convention under section 168(d)). Further, the unit of property as determined under §1.263(a)-3(e) or in published guidance in the Internal Revenue Bulletin under section 263(a) does not apply for purposes of determining what is the appropriate disposed asset.

In addition to these general rules, the final regulations retain the special rules in the 2013 proposed regulations for certain types of properties. These special rules are the same as the previously discussed special rules for determining the appropriate disposed asset under §1.168(i)-8. The final regulations provide special rules for determining the appropriate disposed asset that is included in a general asset account and that is: (a) a building (including its structural components); (b) a building that includes two or more condominium or cooperative units; (c) an item properly included in one of the asset classes 00.11 through 00.4 of Rev. Proc. 87-56 (1987-2 CB 674) or

classified in one of the categories under section 168(e)(3) (other than a category that includes buildings or structural components; for example, retail motor fuels outlet and qualified leasehold improvement property); or (d) an improvement or addition to an existing asset.

### 3. Disposition Rules

The final regulations retain the disposition rules in the 2013 proposed regulations. Immediately before any disposition of an asset (or a portion thereof) in a general asset account, the final regulations provide that the asset (or a portion thereof) is treated as having an adjusted depreciable basis of zero for purposes of section 1011. Therefore, no loss is realized upon the disposition of the asset (or a portion thereof). The final regulations also provide that any amount realized on a disposition generally is recognized as ordinary income. Further, the final regulations provide that the unadjusted depreciable basis and depreciation reserve of the general asset account are not affected by the disposition. Accordingly, a taxpayer continues to depreciate the general asset account, including the disposed asset (or a portion thereof), as though no disposition occurred.

The final regulations also allow a taxpayer to terminate general asset account treatment upon certain dispositions. Under the final regulations, a taxpayer may elect to recognize gain or loss for a general asset account when the taxpayer disposes of all of the assets, the last asset, or the remaining portion of the last asset in the account.

The final regulations further allow a taxpayer to elect to terminate general asset account treatment for an asset in a general asset account when the taxpayer disposes of the asset in a qualifying disposition. A qualifying disposition is a disposition that does

not involve all the assets, the last asset, or the remaining portion of the last asset, remaining in a general asset account and that is: (1) a direct result of a fire, storm, shipwreck, or other casualty, or from theft; (2) a charitable contribution for which a deduction is allowable under section 170; (3) a direct result of a cessation, termination, or disposition of a business, manufacturing, or other income producing process, operation, facility, plant, or other unit (other than by transfer to a supplies, scrap, or similar account); or (4) generally a transaction to which a nonrecognition section of the Code applies. If a taxpayer elects to terminate general asset account treatment for an asset disposed of in a qualifying disposition, the taxpayer must remove the disposed asset from the general asset account and adjust the unadjusted depreciable basis and depreciation reserve of the account.

The final regulations retain the rules in the 2013 proposed regulations on the manner of making (1) the election to terminate the general asset account upon the disposition of all of the assets, the last asset, or the remaining portion of the last asset in that general asset account, or (2) the qualifying disposition election. The final regulations provide that a taxpayer making either of these elections must apply section 280B and §1.280B-1 to determine whether and to what extent gain or loss is recognized. Generally, a taxpayer makes these elections by reporting the gain, loss, or other deduction on the taxpayer's timely filed original Federal tax return (including extensions) for the taxable year in which the disposition occurs.

In the case of a loss sustained on account of the demolition of a structure to which section 280B and §1.280B-1 apply, however, the loss is capitalized to the land on which the demolished structure was located, and no gain or loss is reported at the time

of demolition. Nevertheless, a taxpayer generally will report a depreciation deduction for the demolished structure for the taxable year in which the demolition occurs.

Accordingly, the final regulations clarify that a taxpayer makes the election to terminate the general asset account or the qualifying disposition election by ending depreciation for the demolished structure at the time of disposition (taking into account the applicable convention) and reporting the depreciation amount for that structure for the taxable year in which the disposition occurs on the taxpayer's timely filed original Federal tax return (including extensions) for that taxable year.

For assets in general asset accounts, the final regulations also require a taxpayer to terminate general asset account treatment for an asset that is disposed of in a transaction subject to section 167(i)(7)(B), section 1031, or section 1033, disposed of in an abusive transaction described under the final regulations, or used for any personal use. In such a case, the taxpayer must remove the disposed asset from the general asset account and adjust the unadjusted depreciable basis and depreciation reserve of the account.

In addition, the final regulations require a partnership to terminate its general asset accounts upon the technical termination of the partnership under section 708(b)(1)(B). If there is a redetermination of basis of an asset in a general asset account (for example, due to contingent purchase price or discharge of indebtedness), the final regulations provide that the general asset account election for the asset also applies to the increase or decrease in basis and require the taxpayer to establish a new general asset account for that increase or decrease in basis.

#### 4. Partial Dispositions

The final regulations retain the partial disposition rule in the 2013 proposed regulations. Similar to the partial disposition rule under §1.168(i)-8 that was previously discussed, the disposition rules in §1.168(i)-1 apply to a partial disposition of an asset included in a general asset account. Consequently, a disposition includes a disposition of a portion of an asset as a result of a casualty event described in section 165, a disposition of a portion of an asset for which gain (determined without regard to section 1245 or 1250) is not recognized in whole or in part under section 1031 or 1033, a transfer of a portion of an asset in a transaction described in section 168(i)(7)(B), a sale of a portion of an asset, or a disposition of a portion of an asset in a transaction described under the anti-abuse rules applicable to general asset accounts. For other transactions, a disposition includes a disposition of a portion of an asset only if the taxpayer makes the election to terminate the general asset account upon the disposition of all of the assets, the last asset, or the remaining portion of the last asset in that general asset account or makes the qualifying disposition election for that disposed portion. A separate partial disposition election is not provided for assets in a general asset account because a taxpayer can claim a loss upon the disposition of an asset (or a portion thereof) in a general asset account only when the taxpayer makes either one of these two elections.

D. Determination of basis of disposed asset

The final regulations generally retain the rules in the 2013 proposed regulations on determining the unadjusted depreciable basis of an asset for which general asset account treatment is terminated. Because the general asset account is the asset, the final regulations provide that a taxpayer may use any reasonable method that is

consistently applied to all assets in the same general asset account to determine the unadjusted depreciable basis of a disposed asset in that account if it is impracticable from the taxpayer's records to determine the unadjusted depreciable basis of that asset. This rule also applies when the partial disposition rule applies to a disposition of a portion of an asset included in a general asset account. The IRS and the Treasury Department expect that reasonable methods are available that use information readily available or known to the taxpayer and do not necessitate undertaking an expensive study.

These final regulations also provide nonexclusive examples of reasonable methods. These examples are the same examples in the 2013 proposed regulations, except the final regulations do not include the Consumer Price Index as an example of a reasonable method for the reason previously discussed in II.E. Similar to the rules for determining the unadjusted depreciable basis of a disposed asset under §1.168(i)-8, the final regulations clarify that, when discounting the cost of the replacement asset, using the Producer Price Index for Finished Goods (or its successor, the Producer Price Index for Final Demand) is a reasonable method. The examples in the final regulations include the following: (1) discounting the cost of the replacement asset to its placed-in-service year cost using the Producer Price Index for Finished Goods (or its successor, the Producer Price Index for Final Demand, or any other index designated by guidance in the Internal Revenue Bulletin (see §601.601(d)(2) of the chapter) only if the replacement asset is a restoration under §1.263(a)-3(k) and is not a betterment under §1.263(a)-3(j) or is not an adaptation to a new or different use under §1.263(a)-3(l); (2) a pro rata allocation of the unadjusted depreciable basis of the general asset

account based on the replacement cost of the disposed asset and the replacement cost of all of the assets in the general asset account; and (3) a study allocating the cost of the asset to its individual components.

#### E. Identification of disposed asset

The final regulations retain the rules in the 2013 proposed regulations for determining the placed-in-service year of an asset for which general asset account treatment is terminated. These rules are the same as those previously discussed for identifying the placed-in-service year of the disposed asset for purposes of §1.168(i)-8: the specific identification method, the FIFO method, the modified FIFO method, a mortality dispersion table if the asset is a mass asset, or any other method designated by the Secretary in published guidance. A LIFO method is not permitted. These rules also apply when the partial disposition rule applies to a disposition of a portion of an asset included in a general asset account. The final regulations provide an additional example of the LIFO method, which is impermissible.

#### IV. Accounting for MACRS Property Under §1.168(i)-7

The final regulations retain the rule in the 2013 proposed regulations regarding how to account for a disposed portion of an asset. The final regulations under §1.168(i)-8 provide that if a taxpayer disposes of a portion of an asset and the partial disposition rule applies to that disposition, the taxpayer must account for the disposed portion in a single asset account beginning in the taxable year in which the disposition occurs. This rule also is provided in the final regulations under §1.168(i)-7.

#### V. Conforming Changes

The final regulations also amend §§1.165-2, 1.168(i)-7, 1.263(a)-3, and 1.1016-3 to replace references to the temporary regulations and the 2013 proposed regulations with references to these final regulations.

#### VI. Applicability Dates

The final regulations apply to taxable years beginning on or after January 1, 2014. Alternatively, a taxpayer may choose to apply the final regulations to taxable years beginning on or after January 1, 2012.

A taxpayer also may choose to rely on the provisions of the 2013 proposed regulations for taxable years beginning on or after January 1, 2012, and beginning before January 1, 2014. Finally, a taxpayer may choose to apply the temporary regulations to taxable years beginning on or after January 1, 2012, and beginning before January 1, 2014.

#### **Special Analyses**

It has been determined that this notice of proposed rulemaking is not a significant regulatory action as defined in Executive Order 12866, as supplemented by Executive Order 13563. Therefore, a regulatory assessment is not required. It also has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations, and because these regulations do not impose a collection of information on small entities, the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply. Pursuant to section 7805(f) of the Code, the 2013 proposed regulations preceding this regulation were submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on their impact on small business, and no comments were received.

## Statement of Availability for IRS Document

For copies of recently issued Revenue Procedures, Revenue Rulings, notices, and other guidance published in the Internal Revenue Bulletin please visit the IRS website at <http://www.irs.gov> or the Superintendent of Documents, U.S. Government Printing Office, Washington, DC 20402.

## Drafting Information

The principal author of these regulations is Kathleen Reed, Office of the Associate Chief Counsel (Income Tax and Accounting). However, other personnel from the IRS and the Treasury Department participated in their development.

## List of Subjects in 26 CFR Part 1

Income taxes, Reporting and recordkeeping requirements.

## Adoption of Amendments to the Regulations

Accordingly, 26 CFR Part 1 is amended as follows:

### PART 1--INCOME TAXES

Paragraph 1. The authority citation for part 1 is revised by adding an entry for §1.168(i)-1 to read as follows:

Authority: 26 U.S.C. 7805 \* \* \*

Section 1.168(i)-1 also issued under 26 U.S.C. 168(i)(4).

Par. 2. Section 1.165-2 is amended by revising the first sentence in paragraph (c) to read as follows:

§1.165-2 Obsolescence of nondepreciable property.

\* \* \* \* \*

(c) Cross references. For the allowance under section 165(a) of losses arising

from the permanent withdrawal of depreciable property from use in the trade or business or in the production of income, see §1.167(a)-8, §1.168(i)-1, or §1.168(i)-8, as applicable. \* \* \*

\* \* \* \* \*

Par. 3. Section 1.168(i)-0 is amended by:

a. Redesignating the entries for paragraphs (b)(4), (5), and (6) as paragraphs (b)(5), (6), and (7), respectively, and revising newly redesignated paragraphs (b)(6) and (7).

b. Adding entries for paragraphs (b)(4), (b)(8), and (b)(9).

c. Revising entries for paragraphs (c)(3), (d)(2), (d)(3), (e), (e)(1), (e)(2)(v) through (viii), (e)(3)(vi), (h)(1), (i), and (m).

d. Adding entries for paragraphs (e)(1)(i) and (ii).

e. Removing the entry for paragraph (h)(2) and redesignating the entry for paragraph (h)(3) as paragraph (h)(2).

The additions and revisions read as follows:

§1.168(i)-0 Table of contents for the general asset account rules.

\* \* \* \* \*

§1.168(i)-1 General asset accounts.

\* \* \* \* \*

(b) \* \* \*

(4) Building.

\* \* \*

(6) Mass assets.

(7) Portion of an asset.

(8) Remaining adjusted depreciable basis of the general asset account.

(9) Structural component.

(c) \* \* \*

(3) Examples.

\* \* \* \* \*

(d) \* \* \*

(2) Assets in general asset account are eligible for additional first year depreciation deduction.

(3) No assets in general asset account are eligible for additional first year depreciation deduction.

\* \* \* \* \*

(e) Dispositions from a general asset account.

(1) Scope and definition.

(i) In general.

(ii) Disposition of a portion of an asset.

(2) \* \* \*

(v) Manner of disposition.

(vi) Disposition by transfer to a supplies account.

(vii) Leasehold improvements.

(viii) Determination of asset disposed of.

\* \* \* \* \*

(3) \* \* \*

(vi) Technical termination of a partnership.

\* \* \* \* \*

(h) \* \* \*

(1) Conversion to any personal use.

\* \* \* \* \*

(i) Redetermination of basis.

\* \* \* \* \*

(m) Effective/applicability dates.

### **§1.168(i)-0T [Removed]**

Par. 4. Section 1.168(i)-0T is removed.

Par. 5. Section 1.168(i)-1 is amended by revising paragraphs (a) through (l)(1), and (m) to read as follows:

#### **§1.168(i)-1 General asset accounts.**

(a) Scope. This section provides rules for general asset accounts under section 168(i)(4). The provisions of this section apply only to assets for which an election has been made under paragraph (l) of this section.

(b) Definitions. For purposes of this section, the following definitions apply:

(1) Unadjusted depreciable basis has the same meaning given such term in §1.168(b)-1(a)(3).

(2) Unadjusted depreciable basis of the general asset account is the sum of the unadjusted depreciable bases of all assets included in the general asset account.

(3) Adjusted depreciable basis of the general asset account is the unadjusted depreciable basis of the general asset account less the adjustments to basis described in section 1016(a)(2) and (3).

(4) Building has the same meaning as that term is defined in §1.48-1(e)(1).

(5) Expensed cost is the amount of any allowable credit or deduction treated as a deduction allowable for depreciation or amortization for purposes of section 1245 (for example, a credit allowable under section 30 or a deduction allowable under section 179, section 179A, or section 190). Expensed cost does not include any additional first year depreciation deduction.

(6) Mass assets is a mass or group of individual items of depreciable assets--

- (i) That are not necessarily homogenous;
- (ii) Each of which is minor in value relative to the total value of the mass or group;
- (iii) Numerous in quantity;
- (iv) Usually accounted for only on a total dollar or quantity basis;
- (v) With respect to which separate identification is impracticable; and
- (vi) Placed in service in the same taxable year.

(7) Portion of an asset is any part of an asset that is less than the entire asset as determined under paragraph (e)(2)(viii) of this section.

(8) Remaining adjusted depreciable basis of the general asset account is the unadjusted depreciable basis of the general asset account less the amount of the

additional first year depreciation deduction allowed or allowable, whichever is greater, for the general asset account.

(9) Structural component has the same meaning as that term is defined in §1.48-1(e)(2).

(c) Establishment of general asset accounts--(1) Assets eligible for general asset accounts--(i) General rules. Assets that are subject to either the general depreciation system of section 168(a) or the alternative depreciation system of section 168(g) may be accounted for in one or more general asset accounts. An asset is included in a general asset account only to the extent of the asset's unadjusted depreciable basis. However, an asset is not to be included in a general asset account if the asset is used both in a trade or business or for the production of income and in a personal activity at any time during the taxable year in which the asset is placed in service by the taxpayer or if the asset is placed in service and disposed of during the same taxable year.

(ii) Special rules for assets generating foreign source income. (A) Assets that generate foreign source income, both United States and foreign source income, or combined gross income of a foreign sales corporation (as defined in former section 922), domestic international sales corporation (as defined in section 992(a)), or possession corporation (as defined in section 936) and its related supplier may be included in a general asset account if the requirements of paragraph (c)(2)(i) of this section are satisfied. If, however, the inclusion of these assets in a general asset account results in a substantial distortion of income, the Commissioner may disregard the general asset account election and make any reallocations of income or expense necessary to clearly reflect income.

(B) A general asset account shall be treated as a single asset for purposes of applying the rules in §1.861-9T(g)(3) (relating to allocation and apportionment of interest expense under the asset method). A general asset account that generates income in more than one grouping of income (statutory and residual) is a multiple category asset (as defined in §1.861-9T(g)(3)(ii)), and the income yield from the general asset account must be determined by applying the rules for multiple category assets as if the general asset account were a single asset.

(2) Grouping assets in general asset accounts--(i) General rules. If a taxpayer makes the election under paragraph (l) of this section, assets that are subject to the election are grouped into one or more general asset accounts. Assets that are eligible to be grouped into a single general asset account may be divided into more than one general asset account. Each general asset account must include only assets that--

- (A) Have the same applicable depreciation method;
- (B) Have the same applicable recovery period;
- (C) Have the same applicable convention; and
- (D) Are placed in service by the taxpayer in the same taxable year.

(ii) Special rules. In addition to the general rules in paragraph (c)(2)(i) of this section, the following rules apply when establishing general asset accounts--

(A) Assets subject to the mid-quarter convention may only be grouped into a general asset account with assets that are placed in service in the same quarter of the taxable year;

(B) Assets subject to the mid-month convention may only be grouped into a general asset account with assets that are placed in service in the same month of the taxable year;

(C) Passenger automobiles for which the depreciation allowance is limited under section 280F(a) must be grouped into a separate general asset account;

(D) Assets not eligible for any additional first year depreciation deduction (including assets for which the taxpayer elected not to deduct the additional first year depreciation) provided by, for example, section 168(k), section 168(l), section 168(m), section 168(n), section 1400L(b), or section 1400N(d), must be grouped into a separate general asset account;

(E) Assets eligible for the additional first year depreciation deduction may only be grouped into a general asset account with assets for which the taxpayer claimed the same percentage of the additional first year depreciation (for example, 30 percent, 50 percent, or 100 percent);

(F) Except for passenger automobiles described in paragraph (c)(2)(ii)(C) of this section, listed property (as defined in section 280F(d)(4)) must be grouped into a separate general asset account;

(G) Assets for which the depreciation allowance for the placed-in-service year is not determined by using an optional depreciation table (for further guidance, see section 8 of Rev. Proc. 87-57, 1987-2 CB 687, 693 (see §601.601(d)(2) of this chapter)) must be grouped into a separate general asset account;

(H) Mass assets that are or will be subject to paragraph (j)(2)(i)(D) of this section (disposed of or converted mass asset is identified by a mortality dispersion table) must be grouped into a separate general asset account; and

(I) Assets subject to paragraph (h)(2)(iii)(A) of this section (change in use results in a shorter recovery period or a more accelerated depreciation method) for which the depreciation allowance for the year of change (as defined in §1.168(i)-4(a)) is not determined by using an optional depreciation table must be grouped into a separate general asset account.

(3) Examples. The following examples illustrate the application of this paragraph (c):

Example 1. In 2014, J, a proprietorship with a calendar year-end, purchases and places in service one item of equipment that costs \$550,000. This equipment is section 179 property and also is 5-year property under section 168(e). On its Federal tax return for 2014, J makes an election under section 179 to expense \$25,000 of the equipment's cost and makes an election under paragraph (I) of this section to include the equipment in a general asset account. As a result, the unadjusted depreciable basis of the equipment is \$525,000. In accordance with paragraph (c)(1) of this section, J must include only \$525,000 of the equipment's cost in the general asset account.

Example 2. In 2014, K, a proprietorship with a calendar year-end, purchases and places in service 100 items of equipment. All of these items are 5-year property under section 168(e), are not listed property, and are not eligible for any additional first year depreciation deduction. On its Federal tax return for 2014, K does not make an election under section 179 to expense the cost of any of the 100 items of equipment and does make an election under paragraph (I) of this section to include the 100 items of equipment in a general asset account. K depreciates its 5-year property placed in service in 2014 using the optional depreciation table that corresponds with the general depreciation system, the 200-percent declining balance method, a 5-year recovery period, and the half-year convention. In accordance with paragraph (c)(2) of this section, K includes all of the 100 items of equipment in one general asset account.

Example 3. The facts are the same as in Example 2, except that K decides not to include all of the 100 items of equipment in one general asset account. Instead and in accordance with paragraph (c)(2) of this section, K establishes 100 general asset accounts and includes one item of equipment in each general asset account.

Example 4. L, a calendar-year corporation, is a wholesale distributor. In 2014, L places in service the following properties for use in its wholesale distribution business: computers, automobiles, and forklifts. On its Federal tax return for 2014, L does not make an election under section 179 to expense the cost of any of these items of equipment and does make an election under paragraph (l) of this section to include all of these items of equipment in a general asset account. All of these items are 5-year property under section 168(e) and are not eligible for any additional first year depreciation deduction. The computers are listed property, and the automobiles are listed property and are subject to section 280F(a). L depreciates its 5-year property placed in service in 2014 using the optional depreciation table that corresponds with the general depreciation system, the 200-percent declining balance method, a 5-year recovery period, and the half-year convention. Although the computers, automobiles, and forklifts are 5-year property, L cannot include all of them in one general asset account because the computers and automobiles are listed property. Further, even though the computers and automobiles are listed property, L cannot include them in one general asset account because the automobiles also are subject to section 280F(a). In accordance with paragraph (c)(2) of this section, L establishes three general asset accounts: one for the computers, one for the automobiles, and one for the forklifts.

Example 5. M, a fiscal-year corporation with a taxable year ending June 30, purchases and places in service ten items of new equipment in October 2014, and purchases and places in service five other items of new equipment in February 2015. On its Federal tax return for the taxable year ending June 30, 2015, M does not make an election under section 179 to expense the cost of any of these items of equipment and does make an election under paragraph (l) of this section to include all of these items of equipment in a general asset account. All of these items of equipment are 7-year property under section 168(e), are not listed property, and are property described in section 168(k)(2)(B). All of the ten items of equipment placed in service in October 2014 are eligible for the 50-percent additional first year depreciation deduction provided by section 168(k)(1). All of the five items of equipment placed in service in February 2015 are not eligible for any additional first year depreciation deduction. M depreciates its 7-year property placed in service for the taxable year ending June 30, 2015, using the optional depreciation table that corresponds with the general depreciation system, the 200-percent declining balance method, a 7-year recovery period, and the half-year convention. Although the 15 items of equipment are depreciated using the same depreciation method, recovery period, and convention, M cannot include all of them in one general asset account because some of items of equipment are not eligible for any additional first year depreciation deduction. In accordance with paragraph (c)(2) of this section, M establishes two general asset accounts: one for the ten items of equipment eligible for the 50-percent additional first year depreciation deduction and one for the five items of equipment not eligible for any additional first year depreciation deduction.

(d) Determination of depreciation allowance--(1) In general. Depreciation allowances are determined for each general asset account. The depreciation

allowances must be recorded in a depreciation reserve account for each general asset account. The allowance for depreciation under this section constitutes the amount of depreciation allowable under section 167(a).

(2) Assets in general asset account are eligible for additional first year depreciation deduction. If all the assets in a general asset account are eligible for the additional first year depreciation deduction, the taxpayer first must determine the allowable additional first year depreciation deduction for the general asset account for the placed-in-service year and then must determine the amount otherwise allowable as a depreciation deduction for the general asset account for the placed-in-service year and any subsequent taxable year. The allowable additional first year depreciation deduction for the general asset account for the placed-in-service year is determined by multiplying the unadjusted depreciable basis of the general asset account by the additional first year depreciation deduction percentage applicable to the assets in the account (for example, 30 percent, 50 percent, or 100 percent). The remaining adjusted depreciable basis of the general asset account then is depreciated using the applicable depreciation method, recovery period, and convention for the assets in the account.

(3) No assets in general asset account are eligible for additional first year depreciation deduction. If none of the assets in a general asset account are eligible for the additional first year depreciation deduction, the taxpayer must determine the allowable depreciation deduction for the general asset account for the placed-in-service year and any subsequent taxable year by using the applicable depreciation method, recovery period, and convention for the assets in the account.

(4) Special rule for passenger automobiles. For purposes of applying section 280F(a), the depreciation allowance for a general asset account established for passenger automobiles is limited for each taxable year to the amount prescribed in section 280F(a) multiplied by the excess of the number of automobiles originally included in the account over the number of automobiles disposed of during the taxable year or in any prior taxable year in a transaction described in paragraph (e)(3)(iii) (disposition of an asset in a qualifying disposition), paragraph (e)(3)(iv) (transactions subject to section 168(i)(7)), paragraph (e)(3)(v) (transactions subject to section 1031 or section 1033), paragraph (e)(3)(vi) (technical termination of a partnership), paragraph (e)(3)(vii) (anti-abuse rule), paragraph (g) (assets subject to recapture), or paragraph (h)(1) (conversion to any personal use) of this section.

(e) Dispositions from a general asset account--(1) Scope and definition--(i) In general. This paragraph (e) provides rules applicable to dispositions of assets included in a general asset account. For purposes of this paragraph (e), an asset in a general asset account is disposed of when ownership of the asset is transferred or when the asset is permanently withdrawn from use either in the taxpayer's trade or business or in the production of income. A disposition includes the sale, exchange, retirement, physical abandonment, or destruction of an asset. A disposition also occurs when an asset is transferred to a supplies, scrap, or similar account, or when a portion of an asset is disposed of as described in paragraph (e)(1)(ii) of this section. If a structural component, or a portion thereof, of a building is disposed of in a disposition described in paragraph (e)(1)(ii) of this section, a disposition also includes the disposition of such structural component or such portion thereof.

(ii) Disposition of a portion of an asset. For purposes of applying paragraph (e) of this section, a disposition includes a disposition of a portion of an asset in a general asset account as a result of a casualty event described in section 165, a disposition of a portion of an asset in a general asset account for which gain, determined without regard to section 1245 or section 1250, is not recognized in whole or in part under section 1031 or section 1033, a transfer of a portion of an asset in a general asset account in a transaction described in section 168(i)(7)(B), a sale of a portion of an asset in a general asset account, or a disposition of a portion of an asset in a general asset account in a transaction described in paragraph (e)(3)(vii)(B) of this section. For other transactions, a disposition includes a disposition of a portion of an asset in a general asset account only if the taxpayer makes the election under paragraph (e)(3)(ii) of this section to terminate the general asset account in which that disposed portion is included or makes the election under paragraph (e)(3)(iii) of this section for that disposed portion.

(2) General rules for a disposition--(i) No immediate recovery of basis. Except as provided in paragraph (e)(3) of this section, immediately before a disposition of any asset in a general asset account or a disposition of a portion of such asset as described in paragraph (e)(1)(ii) of this section, the asset or the portion of the asset, as applicable, is treated as having an adjusted depreciable basis (as defined in §1.168(b)-1(a)(4)) of zero for purposes of section 1011. Therefore, no loss is realized upon the disposition of an asset from the general asset account or upon the disposition of a portion of such asset as described in paragraph (e)(1)(ii) of this section. Similarly, where an asset or a portion of an asset, as applicable, is disposed of by transfer to a supplies, scrap, or

similar account, the basis of the asset or the portion of the asset, as applicable, in the supplies, scrap, or similar account will be zero.

(ii) Treatment of amount realized. Any amount realized on a disposition is recognized as ordinary income, notwithstanding any other provision of subtitle A of the Internal Revenue Code (Code), to the extent the sum of the unadjusted depreciable basis of the general asset account and any expensed cost (as defined in paragraph (b)(5) of this section) for assets in the account exceeds any amounts previously recognized as ordinary income upon the disposition of other assets in the account or upon the disposition of portions of such assets as described in paragraph (e)(1)(ii) of this section. The recognition and character of any excess amount realized are determined under other applicable provisions of the Code other than sections 1245 and 1250 or provisions of the Code that treat gain on a disposition as subject to section 1245 or section 1250.

(iii) Effect of disposition on a general asset account. Except as provided in paragraph (e)(3) of this section, the unadjusted depreciable basis and the depreciation reserve of the general asset account are not affected as a result of a disposition of an asset from the general asset account or of a disposition of a portion of such asset as described in paragraph (e)(1)(ii) of this section.

(iv) Coordination with nonrecognition provisions. For purposes of determining the basis of an asset or a portion of an asset, as applicable, acquired in a transaction, other than a transaction described in paragraph (e)(3)(iv) (pertaining to transactions subject to section 168(i)(7)), paragraph (e)(3)(v) (pertaining to transactions subject to section 1031 or section 1033), and paragraph (e)(3)(vi) (pertaining to technical

terminations of partnerships) of this section, to which a nonrecognition section of the Code applies, determined without regard to this section, the amount of ordinary income recognized under this paragraph (e)(2) is treated as the amount of gain recognized on the disposition.

(v) Manner of disposition. The manner of disposition (for example, normal retirement, abnormal retirement, ordinary retirement, or extraordinary retirement) is not taken into account in determining whether a disposition occurs or gain or loss is recognized.

(vi) Disposition by transfer to a supplies account. If a taxpayer made an election under §1.162-3(d) to treat the cost of any rotatable spare part, temporary spare part, or standby emergency spare part (as defined in §1.162-3(c)) as a capital expenditure subject to the allowance for depreciation and also made an election under paragraph (l) of this section to include that rotatable, temporary, or standby emergency spare part in a general asset account, the taxpayer can dispose of the rotatable, temporary, or standby emergency spare part by transferring it to a supplies account only if the taxpayer has obtained the consent of the Commissioner to revoke the §1.162-3(d) election. If a taxpayer made an election under §1.162-3T(d) to treat the cost of any material and supply (as defined in §1.162-3T(c)(1)) as a capital expenditure subject to the allowance for depreciation and also made an election under paragraph (l) of this section to include that material and supply in a general asset account, the taxpayer can dispose of the material and supply by transferring it to a supplies account only if the taxpayer has obtained the consent of the Commissioner to revoke the §1.162-3T(d) election. See §1.162-3(d)(3) for the procedures for revoking a §1.162-3(d) or a §1.162-3T(d) election.

(vii) Leasehold improvements. The rules of paragraph (e) of this section also apply to--

(A) A lessor of leased property that made an improvement to that property for the lessee of the property, has a depreciable basis in the improvement, made an election under paragraph (l) of this section to include the improvement in a general asset account, and disposes of the improvement, or disposes of a portion of the improvement as described in paragraph (e)(1)(ii) of this section, before or upon the termination of the lease with the lessee. See section 168(i)(8)(B); and

(B) A lessee of leased property that made an improvement to that property, has a depreciable basis in the improvement, made an election under paragraph (l) of this section to include the improvement in a general asset account, and disposes of the improvement, or disposes of a portion of the improvement as described in paragraph (e)(1)(ii) of this section, before or upon the termination of the lease.

(viii) Determination of asset disposed of--(A) General rules. For purposes of applying paragraph (e) of this section to the disposition of an asset in a general asset account, instead of the disposition of the general asset account, the facts and circumstances of each disposition are considered in determining what is the appropriate asset disposed of. The asset for disposition purposes may not consist of items placed in service by the taxpayer on different dates, without taking into account the applicable convention. For purposes of determining what is the appropriate asset disposed of, the unit of property determination under §1.263(a)-3(e) or in published guidance in the Internal Revenue Bulletin under section 263(a) (see §601.601(d)(2) of this chapter) does not apply.

(B) Special rules. In addition to the general rules in paragraph (e)(2)(viii)(A) of this section, the following rules apply for purposes of applying paragraph (e) of this section to the disposition of an asset in a general asset account instead of the disposition of the general asset account:

(1) Each building, including its structural components, is the asset, except as provided in §1.1250-1(a)(2)(ii) or in paragraph (e)(2)(viii)(B)(2) or (4) of this section.

(2) If a building has two or more condominium or cooperative units, each condominium or cooperative unit, including its structural components, is the asset, except as provided in §1.1250-1(a)(2)(ii) or in paragraph (e)(2)(viii)(B)(4) of this section.

(3) If a taxpayer properly includes an item in one of the asset classes 00.11 through 00.4 of Rev. Proc. 87-56 (1987-2 CB 674) (see §601.601(d)(2) of this chapter) or properly classifies an item in one of the categories under section 168(e)(3), except for a category that includes buildings or structural components (for example, retail motor fuels outlet, qualified leasehold improvement property, qualified restaurant property, and qualified retail improvement property), each item is the asset, provided that paragraph (e)(2)(viii)(B)(4) of this section does not apply to the item. For example, each desk is the asset, each computer is the asset, and each qualified smart electric meter is the asset.

(4) 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 and, if applicable, its structural components are a separate asset.

(ix) Examples. The following examples illustrate the application of this paragraph (e)(2):

Example 1. A, a calendar-year partnership, maintains one general asset account for one office building that cost \$10 million. A discovers a leak in the roof of the building and decides to replace the entire roof. The roof is a structural component of the building. In accordance with paragraph (e)(2)(viii)(B)(1) of this section, the office building, including its structural components, is the asset for disposition purposes. The retirement of the replaced roof is not a disposition of a portion of an asset as described in paragraph (e)(1)(ii) of this section. Thus, the retirement of the replaced roof is not a disposition under paragraph (e)(1) of this section. As a result, A continues to depreciate the \$10 million cost of the general asset account. If A must capitalize the amount paid for the replacement roof pursuant to §1.263(a)-3, the replacement roof is a separate asset for disposition purposes pursuant to paragraph (e)(2)(viii)(B)(4) of this section and for depreciation purposes pursuant to section 168(i)(6).

Example 2. B, a calendar-year commercial airline company, maintains one general asset account for five aircraft that cost a total of \$500 million. These aircraft are described in asset class 45.0 of Rev. Proc. 87-56. B replaces the existing engines on one of the aircraft with new engines. Assume each aircraft is a unit of property as determined under §1.263(a)-3(e)(3) and each engine of an aircraft is a major component or substantial structural part of the aircraft as determined under §1.263(a)-3(k)(6). Assume also that B treats each aircraft as the asset for disposition purposes in accordance with paragraph (e)(2)(viii) of this section. The retirement of the replaced engines is not a disposition of a portion of an asset as described in paragraph (e)(1)(ii) of this section. Thus, the retirement of the replaced engines is not a disposition under paragraph (e)(1) of this section. As a result, B continues to depreciate the \$500 million cost of the general asset account. If B must capitalize the amount paid for the replacement engines pursuant to §1.263(a)-3, the replacement engines are a separate asset for disposition purposes pursuant to paragraph (e)(2)(viii)(B)(4) of this section and for depreciation purposes pursuant to section 168(i)(6).

Example 3. (i) R, a calendar-year corporation, maintains one general asset account for ten machines. The machines cost a total of \$10,000 and are placed in service in June 2014. Of the ten machines, one machine costs \$8,200 and nine machines cost a total of \$1,800. Assume R depreciates this general asset account using the optional depreciation table that corresponds with the general depreciation system, the 200-percent declining balance method, a 5-year recovery period, and a half-year convention. R does not make a section 179 election for any of the machines, and all of the machines are not eligible for any additional first year depreciation deduction. As of January 1, 2015, the depreciation reserve of the account is \$2,000 (\$10,000 x 20%).

(ii) On February 8, 2015, R sells the machine that cost \$8,200 to an unrelated party for \$9,000. Under paragraph (e)(2)(i) of this section, this machine has an adjusted depreciable basis of zero.

(iii) On its 2015 tax return, R recognizes the amount realized of \$9,000 as ordinary income because such amount does not exceed the unadjusted depreciable

basis of the general asset account (\$10,000), plus any expensed cost for assets in the account (\$0), less amounts previously recognized as ordinary income (\$0). Moreover, the unadjusted depreciable basis and depreciation reserve of the account are not affected by the disposition of the machine. Thus, the depreciation allowance for the account in 2015 is \$3,200 ( $\$10,000 \times 32\%$ ).

Example 4. (i) The facts are the same as in Example 3. In addition, on June 4, 2016, R sells seven machines to an unrelated party for a total of \$1,100. In accordance with paragraph (e)(2)(i) of this section, these machines have an adjusted depreciable basis of zero.

(ii) On its 2016 tax return, R recognizes \$1,000 as ordinary income (the unadjusted depreciable basis of \$10,000, plus the expensed cost of \$0, less the amount of \$9,000 previously recognized as ordinary income). The recognition and character of the excess amount realized of \$100 ( $\$1,100 - \$1,000$ ) are determined under applicable provisions of the Code other than section 1245 (such as section 1231). Moreover, the unadjusted depreciable basis and depreciation reserve of the account are not affected by the disposition of the machines. Thus, the depreciation allowance for the account in 2016 is \$1,920 ( $\$10,000 \times 19.2\%$ ).

(3) Special rules--(i) In general. This paragraph (e)(3) provides the rules for terminating general asset account treatment upon certain dispositions. While the rules under paragraphs (e)(3)(ii) and (iii) of this section are optional rules, the rules under paragraphs (e)(3)(iv), (v), (vi), and (vii) of this section are mandatory rules. A taxpayer elects to apply paragraph (e)(3)(ii) or (iii) of this section by reporting the gain, loss, or other deduction on the taxpayer's timely filed original Federal tax return, including extensions, for the taxable year in which the disposition occurs. However, if the loss is on account of the demolition of a structure to which section 280B and §1.280B-1 apply, a taxpayer elects to apply paragraph (e)(3)(ii) or (iii) of this section by ending depreciation for the structure at the time of the disposition of the structure, taking into account the convention applicable to the general asset account in which the demolished structure was included, and reporting the amount of depreciation for that structure for the taxable year in which the disposition occurs on the taxpayer's timely filed original

Federal tax return, including extensions, for that taxable year. A taxpayer may revoke the election to apply paragraph (e)(3)(ii) or (iii) of this section only by filing a request for a private letter ruling and obtaining the Commissioner's consent to revoke the election. The Commissioner may grant a request to revoke this election if the taxpayer acted reasonably and in good faith, and the revocation will not prejudice the interests of the Government. See generally §301.9100-3 of this chapter. The election to apply paragraph (e)(3)(ii) or (iii) of this section may not be made or revoked through the filing of an application for change in accounting method. For purposes of applying paragraphs (e)(3)(iii) through (vii) of this section, see paragraph (j) of this section for identifying an asset disposed of and its unadjusted depreciable basis. Solely for purposes of applying paragraphs (e)(3)(iii), (e)(3)(iv)(C), (e)(3)(v)(B), and (e)(3)(vii) of this section, the term asset is:

- (A) The asset as determined under paragraph (e)(2)(viii) of this section; or
- (B) The portion of such asset that is disposed of in a disposition described in paragraph (e)(1)(ii) of this section.

(ii) Disposition of all assets remaining in a general asset account--(A) Optional termination of a general asset account. Upon the disposition of all of the assets, the last asset, or the remaining portion of the last asset in a general asset account, a taxpayer may apply this paragraph (e)(3)(ii) to recover the adjusted depreciable basis of the general asset account rather than having paragraph (e)(2) of this section apply. Under this paragraph (e)(3)(ii), the general asset account terminates and the amount of gain or loss for the general asset account is determined under section 1001(a) by taking into account the adjusted depreciable basis of the general asset account at the time of the

disposition, as determined under the applicable convention for the general asset account. Whether and to what extent gain or loss is recognized is determined under other applicable provisions of the Code, including section 280B and §1.280B-1. The character of the gain or loss is determined under other applicable provisions of the Code, except that the amount of gain subject to section 1245 is limited to the excess of the depreciation allowed or allowable for the general asset account, including any expensed cost, over any amounts previously recognized as ordinary income under paragraph (e)(2) of this section, and the amount of gain subject to section 1250 is limited to the excess of the additional depreciation allowed or allowable for the general asset account, over any amounts previously recognized as ordinary income under paragraph (e)(2) of this section.

(B) Examples. The following examples illustrate the application of this paragraph (e)(3)(ii):

Example 1. (i) T, a calendar-year corporation, maintains a general asset account for 1,000 calculators. The calculators cost a total of \$60,000 and are placed in service in 2014. Assume T depreciates this general asset account using the optional depreciation table that corresponds with the general depreciation system, the 200-percent declining balance method, a 5-year recovery period, and a half-year convention. T does not make a section 179 election for any of the calculators, and all of the calculators are not eligible for any additional first year depreciation deduction. In 2015, T sells 200 of the calculators to an unrelated party for a total of \$10,000 and recognizes the \$10,000 as ordinary income in accordance with paragraph (e)(2) of this section.

(ii) On March 26, 2016, T sells the remaining calculators in the general asset account to an unrelated party for \$35,000. T elects to apply paragraph (e)(3)(ii) of this section. As a result, the account terminates and gain or loss is determined for the account.

(iii) On the date of disposition, the adjusted depreciable basis of the account is \$23,040 (unadjusted depreciable basis of \$60,000 less the depreciation allowed or allowable of \$36,960). Thus, in 2016, T recognizes gain of \$11,960 (amount realized of \$35,000 less the adjusted depreciable basis of \$23,040). The gain of \$11,960 is subject to section 1245 to the extent of the depreciation allowed or allowable for the account,

plus the expensed cost for assets in the account, less the amounts previously recognized as ordinary income ( $\$36,960 + \$0 - \$10,000 = \$26,960$ ). As a result, the entire gain of  $\$11,960$  is subject to section 1245.

Example 2. (i) J, a calendar-year corporation, maintains a general asset account for one item of equipment. This equipment costs  $\$2,000$  and is placed in service in 2014. Assume J depreciates this general asset account using the optional depreciation table that corresponds with the general depreciation system, the 200-percent declining balance method, a 5-year recovery period, and a half-year convention. J does not make a section 179 election for the equipment, and it is not eligible for any additional first year depreciation deduction. In June 2016, J sells the equipment to an unrelated party for  $\$1,000$ . J elects to apply paragraph (e)(3)(ii) of this section. As a result, the account terminates and gain or loss is determined for the account.

(ii) On the date of disposition, the adjusted depreciable basis of the account is  $\$768$  (unadjusted depreciable basis of  $\$2,000$  less the depreciation allowed or allowable of  $\$1,232$ ). Thus, in 2016, J recognizes gain of  $\$232$  (amount realized of  $\$1,000$  less the adjusted depreciable basis of  $\$768$ ). The gain of  $\$232$  is subject to section 1245 to the extent of the depreciation allowed or allowable for the account (plus the expensed cost for assets in the account) less the amounts previously recognized as ordinary income ( $\$1,232 + \$0 - \$0 = \$1,232$ ). As a result, the entire gain of  $\$232$  is subject to section 1245.

(iii) Disposition of an asset in a qualifying disposition--(A) Optional determination of the amount of gain, loss, or other deduction. In the case of a qualifying disposition (described in paragraph (e)(3)(iii)(B) of this section) of an asset, a taxpayer may elect to apply this paragraph (e)(3)(iii) rather than having paragraph (e)(2) of this section apply. Under this paragraph (e)(3)(iii), general asset account treatment for the asset terminates as of the first day of the taxable year in which the qualifying disposition occurs, and the amount of gain, loss, or other deduction for the asset is determined under §1.168(i)-8 by taking into account the asset's adjusted depreciable basis at the time of the disposition. The adjusted depreciable basis of the asset at the time of the disposition, as determined under the applicable convention for the general asset account in which the asset was included, equals the unadjusted depreciable basis of the asset less the depreciation allowed or allowable for the asset, computed by using the

depreciation method, recovery period, and convention applicable to the general asset account in which the asset was included and by including the portion of the additional first year depreciation deduction claimed for the general asset account that is attributable to the asset disposed of. Whether and to what extent gain, loss, or other deduction is recognized is determined under other applicable provisions of the Code, including section 280B and §1.280B-1. The character of the gain, loss, or other deduction is determined under other applicable provisions of the Code, except that the amount of gain subject to section 1245 or section 1250 is limited to the lesser of--

(1) The depreciation allowed or allowable for the asset, including any expensed cost or, in the case of section 1250 property, the additional depreciation allowed or allowable for the asset; or

(2) The excess of--

(i) The original unadjusted depreciable basis of the general asset account plus, in the case of section 1245 property originally included in the general asset account, any expensed cost; over

(ii) The cumulative amounts of gain previously recognized as ordinary income under either paragraph (e)(2) of this section or section 1245 or section 1250.

(B) Qualifying dispositions. A qualifying disposition is a disposition that does not involve all the assets, the last asset, or the remaining portion of the last asset remaining in a general asset account and that is--

(1) A direct result of a fire, storm, shipwreck, or other casualty, or from theft;

(2) A charitable contribution for which a deduction is allowable under section 170;

(3) A direct result of a cessation, termination, or disposition of a business, manufacturing or other income producing process, operation, facility, plant, or other unit, other than by transfer to a supplies, scrap, or similar account; or

(4) A transaction, other than a transaction described in paragraph (e)(3)(iv) (pertaining to transactions subject to section 168(i)(7)), paragraph (e)(3)(v) (pertaining to transactions subject to section 1031 or section 1033), paragraph (e)(3)(vi) (pertaining to technical terminations of partnerships), or paragraph (e)(3)(vii) (anti-abuse rule) of this section, to which a nonrecognition section of the Internal Revenue Code applies (determined without regard to this section).

(C) Effect of a qualifying disposition on a general asset account. If the taxpayer elects to apply this paragraph (e)(3)(iii) to a qualifying disposition of an asset, then--

(1) The asset is removed from the general asset account as of the first day of the taxable year in which the qualifying disposition occurs. For that taxable year, the taxpayer accounts for the asset in a single asset account in accordance with the rules under §1.168(i)-7(b);

(2) The unadjusted depreciable basis of the general asset account is reduced by the unadjusted depreciable basis of the asset as of the first day of the taxable year in which the disposition occurs;

(3) The depreciation reserve of the general asset account is reduced by the depreciation allowed or allowable for the asset as of the end of the taxable year immediately preceding the year of disposition, computed by using the depreciation method, recovery period, and convention applicable to the general asset account in which the asset was included and by including the portion of the additional first year

depreciation deduction claimed for the general asset account that is attributable to the asset disposed of; and

(4) For purposes of determining the amount of gain realized on subsequent dispositions that is subject to ordinary income treatment under paragraph (e)(2)(ii) of this section, the amount of any expensed cost with respect to the asset is disregarded.

(D) Examples. The following examples illustrate the application of this paragraph (e)(3)(iii):

Example 1. (i) Z, a calendar-year corporation, maintains one general asset account for 12 machines. Each machine costs \$15,000 and is placed in service in 2014. Of the 12 machines, nine machines that cost a total of \$135,000 are used in Z's Kentucky plant, and three machines that cost a total of \$45,000 are used in Z's Ohio plant. Assume Z depreciates this general asset account using the optional depreciation table that corresponds with the general depreciation system, the 200-percent declining balance method, a 5-year recovery period, and the half-year convention. Z does not make a section 179 election for any of the machines, and all of the machines are not eligible for any additional first year depreciation deduction. As of December 31, 2015, the depreciation reserve for the account is \$93,600.

(ii) On May 27, 2016, Z sells its entire manufacturing plant in Ohio to an unrelated party. The sales proceeds allocated to each of the three machines at the Ohio plant is \$5,000. This transaction is a qualifying disposition under paragraph (e)(3)(iii)(B)(3) of this section, and Z elects to apply paragraph (e)(3)(iii) of this section.

(iii) For Z's 2016 return, the depreciation allowance for the account is computed as follows. As of December 31, 2015, the depreciation allowed or allowable for the three machines at the Ohio plant is \$23,400. Thus, as of January 1, 2016, the unadjusted depreciable basis of the account is reduced from \$180,000 to \$135,000 (\$180,000 less the unadjusted depreciable basis of \$45,000 for the three machines), and, as of December 31, 2015, the depreciation reserve of the account is decreased from \$93,600 to \$70,200 (\$93,600 less the depreciation allowed or allowable of \$23,400 for the three machines as of December 31, 2015). Consequently, the depreciation allowance for the account in 2016 is \$25,920 ( $\$135,000 \times 19.2\%$ ).

(iv) For Z's 2016 return, gain or loss for each of the three machines at the Ohio plant is determined as follows. The depreciation allowed or allowable in 2016 for each machine is \$1,440 ( $(\$15,000 \times 19.2\%) / 2$ ). Thus, the adjusted depreciable basis of each machine under section 1011 is \$5,760 (the adjusted depreciable basis of \$7,200 removed from the account less the depreciation allowed or allowable of \$1,440 in 2016).

As a result, the loss recognized in 2016 for each machine is \$760 (\$5,000 - \$5,760), which is subject to section 1231.

Example 2. (i) A, a calendar-year partnership, maintains one general asset account for one office building that cost \$20 million and was placed in service in July 2011. A depreciates this general asset account using the optional depreciation table that corresponds with the general depreciation system, the straight-line method, a 39-year recovery period, and the mid-month convention. As of January 1, 2014, the depreciation reserve for the account is \$1,261,000.

(ii) In May 2014, a tornado occurs where the building is located and damages the roof of the building. A decides to replace the entire roof. The roof is replaced in June 2014. The roof is a structural component of the building. Because the roof was damaged as a result of a casualty event described in section 165, the partial disposition rule provided under paragraph (e)(1)(ii) of this section applies to the roof. Although the office building, including its structural components, is the asset for disposition purposes, the partial disposition rule provides that the retirement of the replaced roof is a disposition under paragraph (e)(1) of this section. This retirement is a qualifying disposition under paragraph (e)(3)(iii)(B)(1) of this section, and A elects to apply paragraph (e)(3)(iii) of this section for the retirement of the damaged roof.

(iii) Of the \$20 million cost of the office building, assume \$1 million is the cost of the retired roof.

(iv) For A's 2014 return, the depreciation allowance for the account is computed as follows. As of December 31, 2013, the depreciation allowed or allowable for the retired roof is \$63,050. Thus, as of January 1, 2014, the unadjusted depreciable basis of the account is reduced from \$20,000,000 to \$19,000,000 (\$20,000,000 less the unadjusted depreciable basis of \$1,000,000 for the retired roof), and the depreciation reserve of the account is decreased from \$1,261,000 to \$1,197,950 (\$1,261,000 less the depreciation allowed or allowable of \$63,050 for the retired roof as of December 31, 2013). Consequently, the depreciation allowance for the account in 2014 is \$487,160 ( $\$19,000,000 \times 2.564\%$ ).

(v) For A's 2014 return, gain or loss for the retired roof is determined as follows. The depreciation allowed or allowable in 2014 for the retired roof is \$11,752 ( $(\$1,000,000 \times 2.564\%) \times 5.5/12$ ). Thus, the adjusted depreciable basis of the retired roof under section 1011 is \$925,198 (the adjusted depreciable basis of \$936,950 removed from the account less the depreciation allowed or allowable of \$11,752 in 2014). As a result, the loss recognized in 2014 for the retired roof is \$925,198, which is subject to section 1231.

(vi) If A must capitalize the amount paid for the replacement roof under §1.263(a)-3, the replacement roof is a separate asset for depreciation purposes pursuant to section 168(i)(6). If A includes the replacement roof in a general asset account, the replacement roof is a separate asset for disposition purposes pursuant to

paragraph (e)(2)(viii)(B)(4) of this section. If A includes the replacement roof in a single asset account or a multiple asset account under §1.168(i)-7, the replacement roof is a separate asset for disposition purposes pursuant to §1.168(i)-8(c)(4)(ii)(D).

(iv) Transactions subject to section 168(i)(7)--(A) In general. If a taxpayer transfers one or more assets, or a portion of such asset, in a general asset account in a transaction described in section 168(i)(7)(B) (pertaining to treatment of transferees in certain nonrecognition transactions), the taxpayer (the transferor) and the transferee must apply this paragraph (e)(3)(iv) to the asset or the portion of such asset, instead of applying paragraph (e)(2), (e)(3)(ii), or (e)(3)(iii) of this section. The transferee is bound by the transferor's election under paragraph (l) of this section for the portion of the transferee's basis in the asset or the portion of such asset that does not exceed the transferor's adjusted depreciable basis of the general asset account or the asset or the portion of such asset, as applicable, as determined under paragraph (e)(3)(iv)(B)(2) or (C)(2) of this section, as applicable.

(B) All assets remaining in general asset account are transferred. If a taxpayer transfers all the assets, the last asset, or the remaining portion of the last asset in a general asset account in a transaction described in section 168(i)(7)(B)--

(1) The taxpayer (the transferor) must terminate the general asset account on the date of the transfer. The allowable depreciation deduction for the general asset account for the transferor's taxable year in which the section 168(i)(7)(B) transaction occurs is computed by using the depreciation method, recovery period, and convention applicable to the general asset account. This allowable depreciation deduction is allocated between the transferor and the transferee on a monthly basis. This allocation is made

in accordance with the rules in §1.168(d)-1(b)(7)(ii) for allocating the depreciation deduction between the transferor and the transferee;

(2) The transferee must establish a new general asset account for all the assets, the last asset, or the remaining portion of the last asset, in the taxable year in which the section 168(i)(7)(B) transaction occurs for the portion of its basis in the assets that does not exceed the transferor's adjusted depreciable basis of the general asset account in which all the assets, the last asset, or the remaining portion of the last asset, were included. The transferor's adjusted depreciable basis of this general asset account is equal to the adjusted depreciable basis of that account as of the beginning of the transferor's taxable year in which the transaction occurs, decreased by the amount of depreciation allocable to the transferor for the year of the transfer, as determined under paragraph (e)(3)(iv)(B)(1) of this section. The transferee is treated as the transferor for purposes of computing the allowable depreciation deduction for the new general asset account under section 168. The new general asset account must be established in accordance with the rules in paragraph (c) of this section, except that the unadjusted depreciable bases of all the assets, the last asset, or the remaining portion of the last asset, and the greater of the depreciation allowed or allowable for all the assets, the last asset, or the remaining portion of the last asset, including the amount of depreciation for the transferred assets that is allocable to the transferor for the year of the transfer, are included in the newly established general asset account. Consequently, this general asset account in the year of the transfer will have a beginning balance for both the unadjusted depreciable basis and the depreciation reserve of the general asset account; and

(3) For purposes of section 168 and this section, the transferee treats the portion of its basis in the assets that exceeds the transferor's adjusted depreciable basis of the general asset account in which all the assets, the last asset, or the remaining portion of the last asset, were included, as determined under paragraph (e)(3)(iv)(B)(2) of this section, as a separate asset that the transferee placed in service on the date of the transfer. The transferee accounts for this asset under §1.168(i)-7 or may make an election under paragraph (l) of this section to include the asset in a general asset account.

(C) Not all assets remaining in general asset account are transferred. If a taxpayer transfers an asset in a general asset account in a transaction described in section 168(i)(7)(B) and if paragraph (e)(3)(iv)(B) of this section does not apply to this asset--

(1) The taxpayer (the transferor) must remove the transferred asset from the general asset account in which the asset is included, as of the first day of the taxable year in which the section 168(i)(7)(B) transaction occurs. In addition, the adjustments to the general asset account described in paragraphs (e)(3)(iii)(C)(2) through (4) of this section must be made. The allowable depreciation deduction for the asset for the transferor's taxable year in which the section 168(i)(7)(B) transaction occurs is computed by using the depreciation method, recovery period, and convention applicable to the general asset account in which the asset was included. This allowable depreciation deduction is allocated between the transferor and the transferee on a monthly basis. This allocation is made in accordance with the rules in §1.168(d)-

1(b)(7)(ii) for allocating the depreciation deduction between the transferor and the transferee;

(2) The transferee must establish a new general asset account for the asset in the taxable year in which the section 168(i)(7)(B) transaction occurs for the portion of its basis in the asset that does not exceed the transferor's adjusted depreciable basis of the asset. The transferor's adjusted depreciable basis of this asset is equal to the adjusted depreciable basis of the asset as of the beginning of the transferor's taxable year in which the transaction occurs, decreased by the amount of depreciation allocable to the transferor for the year of the transfer, as determined under paragraph (e)(3)(iv)(C)(1) of this section. The transferee is treated as the transferor for purposes of computing the allowable depreciation deduction for the new general asset account under section 168. The new general asset account must be established in accordance with the rules in paragraph (c) of this section, except that the unadjusted depreciable basis of the asset, and the greater of the depreciation allowed or allowable for the asset, including the amount of depreciation for the transferred asset that is allocable to the transferor for the year of the transfer, are included in the newly established general asset account. Consequently, this general asset account in the year of the transfer will have a beginning balance for both the unadjusted depreciable basis and the depreciation reserve of the general asset account; and

(3) For purposes of section 168 and this section, the transferee treats the portion of its basis in the asset that exceeds the transferor's adjusted depreciable basis of the asset, as determined under paragraph (e)(3)(iv)(C)(2) of this section, as a separate asset that the transferee placed in service on the date of the transfer. The transferee

accounts for this asset under §1.168(i)-7 or may make an election under paragraph (l) of this section to include the asset in a general asset account.

(v) Transactions subject to section 1031 or section 1033--(A) Like-kind exchange or involuntary conversion of all assets remaining in a general asset account. If all the assets, the last asset, or the remaining portion of the last asset in a general asset account are transferred by a taxpayer in a like-kind exchange (as defined under §1.168-6(b)(11)) or in an involuntary conversion (as defined under §1.168-6(b)(12)), the taxpayer must apply this paragraph (e)(3)(v)(A) instead of applying paragraph (e)(2), (e)(3)(ii), or (e)(3)(iii) of this section. Under this paragraph (e)(3)(v)(A), the general asset account terminates as of the first day of the year of disposition (as defined in §1.168(i)-6(b)(5)) and--

(1) The amount of gain or loss for the general asset account is determined under section 1001(a) by taking into account the adjusted depreciable basis of the general asset account at the time of disposition (as defined in §1.168(i)-6(b)(3)). The depreciation allowance for the general asset account in the year of disposition is determined in the same manner as the depreciation allowance for the relinquished MACRS property (as defined in §1.168(i)-6(b)(2)) in the year of disposition is determined under §1.168(i)-6. The recognition and character of gain or loss are determined in accordance with paragraph (e)(3)(ii)(A) of this section, notwithstanding that paragraph (e)(3)(ii) of this section is an optional rule; and

(2) The adjusted depreciable basis of the general asset account at the time of disposition is treated as the adjusted depreciable basis of the relinquished MACRS property.

(B) Like-kind exchange or involuntary conversion of less than all assets remaining in a general asset account. If an asset in a general asset account is transferred by a taxpayer in a like-kind exchange or in an involuntary conversion and if paragraph (e)(3)(v)(A) of this section does not apply to this asset, the taxpayer must apply this paragraph (e)(3)(v)(B) instead of applying paragraph (e)(2), (e)(3)(ii), or (e)(3)(iii) of this section. Under this paragraph (e)(3)(v)(B), general asset account treatment for the asset terminates as of the first day of the year of disposition (as defined in §1.168(i)-6(b)(5)), and--

(1) The amount of gain or loss for the asset is determined by taking into account the asset's adjusted depreciable basis at the time of disposition (as defined in §1.168(i)-6(b)(3)). The adjusted depreciable basis of the asset at the time of disposition equals the unadjusted depreciable basis of the asset less the depreciation allowed or allowable for the asset, computed by using the depreciation method, recovery period, and convention applicable to the general asset account in which the asset was included and by including the portion of the additional first year depreciation deduction claimed for the general asset account that is attributable to the relinquished asset. The depreciation allowance for the asset in the year of disposition is determined in the same manner as the depreciation allowance for the relinquished MACRS property (as defined in §1.168(i)-6(b)(2)) in the year of disposition is determined under §1.168(i)-6. The recognition and character of the gain or loss are determined in accordance with paragraph (e)(3)(iii)(A) of this section, notwithstanding that paragraph (e)(3)(iii) of this section is an optional rule; and

(2) As of the first day of the year of disposition, the taxpayer must remove the relinquished asset from the general asset account and make the adjustments to the general asset account described in paragraphs (e)(3)(iii)(C)(2) through (4) of this section.

(vi) Technical termination of a partnership. In the case of a technical termination of a partnership under section 708(b)(1)(B), the terminated partnership must apply this paragraph (e)(3)(vi) instead of applying paragraph (e)(2), (e)(3)(ii), or (e)(3)(iii) of this section. Under this paragraph (e)(3)(vi), all of the terminated partnership's general asset accounts terminate as of the date of its termination under section 708(b)(1)(B). The terminated partnership computes the allowable depreciation deduction for each of its general asset accounts for the taxable year in which the technical termination occurs by using the depreciation method, recovery period, and convention applicable to the general asset account. The new partnership is not bound by the terminated partnership's election under paragraph (l) of this section.

(vii) Anti-abuse rule--(A) In general. If an asset in a general asset account is disposed of by a taxpayer in a transaction described in paragraph (e)(3)(vii)(B) of this section, general asset account treatment for the asset terminates as of the first day of the taxable year in which the disposition occurs. Consequently, the taxpayer must determine the amount of gain, loss, or other deduction attributable to the disposition in the manner described in paragraph (e)(3)(iii)(A) of this section, notwithstanding that paragraph (e)(3)(iii)(A) of this section is an optional rule, and must make the adjustments to the general asset account described in paragraphs (e)(3)(iii)(C)(1) through (4) of this section.

(B) Abusive transactions. A transaction is described in this paragraph (e)(3)(vii)(B) if the transaction is not described in paragraph (e)(3)(iv), (e)(3)(v), or (e)(3)(vi) of this section, and if the transaction is entered into, or made, with a principal purpose of achieving a tax benefit or result that would not be available absent an election under this section. Examples of these types of transactions include--

(1) A transaction entered into with a principal purpose of shifting income or deductions among taxpayers in a manner that would not be possible absent an election under this section to take advantage of differing effective tax rates among the taxpayers; or

(2) An election made under this section with a principal purpose of disposing of an asset from a general asset account to utilize an expiring net operating loss or credit if the transaction is not a bona fide disposition. The fact that a taxpayer with a net operating loss carryover or a credit carryover transfers an asset to a related person or transfers an asset pursuant to an arrangement where the asset continues to be used or is available for use by the taxpayer pursuant to a lease or otherwise indicates, absent strong evidence to the contrary, that the transaction is described in this paragraph (e)(3)(vii)(B).

(f) Assets generating foreign source income--(1) In general. This paragraph (f) provides the rules for determining the source of any income, gain, or loss recognized, and the appropriate section 904(d) separate limitation category or categories for any foreign source income, gain, or loss recognized on a disposition (within the meaning of paragraph (e)(1) of this section) of an asset in a general asset account that consists of assets generating both United States and foreign source income. These rules apply

only to a disposition to which paragraph (e)(2) (general disposition rules), paragraph (e)(3)(ii) (disposition of all assets remaining in a general asset account), paragraph (e)(3)(iii) (disposition of an asset in a qualifying disposition), paragraph (e)(3)(v) (transactions subject to section 1031 or section 1033), or paragraph (e)(3)(vii) (anti-abuse rule) of this section applies. Solely for purposes of applying this paragraph (f), the term asset is:

(i) The asset as determined under paragraph (e)(2)(viii) of this section; or  
(ii) The portion of such asset that is disposed of in a disposition described in paragraph (e)(1)(ii) of this section.

(2) Source of ordinary income, gain, or loss--(i) Source determined by allocation and apportionment of depreciation allowed. The amount of any ordinary income, gain, or loss that is recognized on the disposition of an asset in a general asset account must be apportioned between United States and foreign sources based on the allocation and apportionment of the--

(A) Depreciation allowed for the general asset account as of the end of the taxable year in which the disposition occurs if paragraph (e)(2) of this section applies to the disposition;

(B) Depreciation allowed for the general asset account as of the time of disposition if the taxpayer applies paragraph (e)(3)(ii) of this section to the disposition of all assets, the last asset, or the remaining portion of the last asset, in the general asset account, or if all the assets, the last asset, or the remaining portion of the last asset, in the general asset account are disposed of in a transaction described in paragraph (e)(3)(v)(A) of this section; or

(C) Depreciation allowed for the asset disposed of for only the taxable year in which the disposition occurs if the taxpayer applies paragraph (e)(3)(iii) of this section to the disposition of the asset in a qualifying disposition, if the asset is disposed of in a transaction described in paragraph (e)(3)(v)(B) of this section (like-kind exchange or involuntary conversion), or if the asset is disposed of in a transaction described in paragraph (e)(3)(vii) of this section (anti-abuse rule).

(ii) Formula for determining foreign source income, gain, or loss. The amount of ordinary income, gain, or loss recognized on the disposition that shall be treated as foreign source income, gain, or loss must be determined under the formula in this paragraph (f)(2)(ii). For purposes of this formula, the allowed depreciation deductions are determined for the applicable time period provided in paragraph (f)(2)(i) of this section. The formula is:

$$\begin{array}{l} \text{Foreign} \\ \text{Source} \\ \text{Income, Gain,} \\ \text{or Loss from} \\ \text{The} \\ \text{Disposition} \\ \text{of an Asset} \end{array} = \begin{array}{l} \text{Total} \\ \text{Ordinary} \\ \text{Income,} \\ \text{Gain, or} \\ \text{Loss from the} \\ \text{Disposition} \\ \text{of an Asset} \end{array} \times \begin{array}{l} \text{Allowed} \\ \text{Depreciation} \\ \text{Deductions} \\ \text{Allocated and} \\ \text{Apportioned to} \\ \text{Foreign Source} \\ \text{Income/Total} \\ \text{Allowed} \\ \text{Depreciation} \\ \text{Deductions for} \\ \text{the General} \\ \text{Asset Account} \\ \text{or for the} \\ \text{Asset Disposed of} \\ \text{(as applicable)} \end{array}$$

(3) Section 904(d) separate categories. If the assets in the general asset account generate foreign source income in more than one separate category under

section 904(d)(1) or another section of the Code (for example, income treated as foreign source income under section 904(g)(10)), or under a United States income tax treaty that requires the foreign tax credit limitation to be determined separately for specified types of income, the amount of foreign source income, gain, or loss from the disposition of an asset, as determined under the formula in paragraph (f)(2)(ii) of this section, must be allocated and apportioned to the applicable separate category or categories under the formula in this paragraph (f)(3). For purposes of this formula, the allowed depreciation deductions are determined for the applicable time period provided in paragraph (f)(2)(i) of this section. The formula is:

$$\begin{array}{l} \text{Foreign} \\ \text{Source} \\ \text{Income, Gain,} \\ \text{or Loss in a} \\ \text{Separate} \\ \text{Category} \end{array} = \begin{array}{l} \text{Foreign} \\ \text{Source} \\ \text{Income,} \\ \text{Gain, or} \\ \text{Loss from} \\ \text{The} \\ \text{Disposition} \\ \text{of an Asset} \end{array} \times \begin{array}{l} \text{Allowed} \\ \text{Depreciation} \\ \text{Deductions} \\ \text{Allocated and} \\ \text{Apportioned to} \\ \text{a Separate} \\ \text{Category Total/} \\ \text{Allowed} \\ \text{Depreciation} \\ \text{Deductions and} \\ \text{Apportioned to} \\ \text{Foreign Source} \\ \text{Income} \end{array}$$

(g) Assets subject to recapture. If the basis of an asset in a general asset account is increased as a result of the recapture of any allowable credit or deduction (for example, the basis adjustment for the recapture amount under section 30(e)(5), 50(c)(2), 168(l)(6), 168(n)(4), 179(d)(10), 179A(e)(4), or 1400N(d)(5)), general asset account treatment for the asset terminates as of the first day of the taxable year in which the recapture event occurs. Consequently, the taxpayer must remove the asset

from the general asset account as of that day and must make the adjustments to the general asset account described in paragraphs (e)(3)(iii)(C)(2) through (4) of this section.

(h) Changes in use--(1) Conversion to any personal use. An asset in a general asset account becomes ineligible for general asset account treatment if a taxpayer uses the asset in any personal activity during a taxable year. Upon a conversion to any personal use, the taxpayer must remove the asset from the general asset account as of the first day of the taxable year in which the change in use occurs (the year of change) and must make the adjustments to the general asset account described in paragraphs (e)(3)(iii)(C)(2) through (4) of this section.

(2) Change in use results in a different recovery period and/or depreciation method--(i) No effect on general asset account election. A change in the use described in §1.168(i)-4(d) (change in use results in a different recovery period or depreciation method) of an asset in a general asset account shall not cause or permit the revocation of the election made under this section.

(ii) Asset is removed from the general asset account. Upon a change in the use described in §1.168(i)-4(d), the taxpayer must remove the asset from the general asset account as of the first day of the year of change (as defined in §1.168(i)-4(a)) and must make the adjustments to the general asset account described in paragraphs (e)(3)(iii)(C)(2) through (4) of this section. If, however, the result of the change in use is described in §1.168(i)-4(d)(3) (change in use results in a shorter recovery period or a more accelerated depreciation method) and the taxpayer elects to treat the asset as

though the change in use had not occurred pursuant to §1.168(i)-4(d)(3)(ii), no adjustment is made to the general asset account upon the change in use.

(iii) New general asset account is established--(A) Change in use results in a shorter recovery period or a more accelerated depreciation method. If the result of the change in use is described in §1.168(i)-4(d)(3) (change in use results in a shorter recovery period or a more accelerated depreciation method) and adjustments to the general asset account are made pursuant to paragraph (h)(2)(ii) of this section, the taxpayer must establish a new general asset account for the asset in the year of change in accordance with the rules in paragraph (c) of this section, except that the adjusted depreciable basis of the asset as of the first day of the year of change is included in the general asset account. For purposes of paragraph (c)(2) of this section, the applicable depreciation method, recovery period, and convention are determined under §1.168(i)-4(d)(3)(i).

(B) Change in use results in a longer recovery period or a slower depreciation method. If the result of the change in use is described in §1.168(i)-4(d)(4) (change in use results in a longer recovery period or a slower depreciation method), the taxpayer must establish a separate general asset account for the asset in the year of change in accordance with the rules in paragraph (c) of this section, except that the unadjusted depreciable basis of the asset, and the greater of the depreciation of the asset allowed or allowable in accordance with section 1016(a)(2), as of the first day of the year of change are included in the newly established general asset account. Consequently, this general asset account as of the first day of the year of change will have a beginning balance for both the unadjusted depreciable basis and the depreciation reserve of the

general asset account. For purposes of paragraph (c)(2) of this section, the applicable depreciation method, recovery period, and convention are determined under §1.168(i)-4(d)(4)(ii).

(i) Redetermination of basis. If, after the placed-in-service year, the unadjusted depreciable basis of an asset in a general asset account is redetermined due to a transaction other than that described in paragraph (g) of this section (for example, due to contingent purchase price or discharge of indebtedness), the taxpayer's election under paragraph (l) of this section for the asset also applies to the increase or decrease in basis resulting from the redetermination. For the taxable year in which the increase or decrease in basis occurs, the taxpayer must establish a new general asset account for the amount of the increase or decrease in basis in accordance with the rules in paragraph (c) of this section. For purposes of paragraph (c)(2) of this section, the applicable recovery period for the increase or decrease in basis is the recovery period of the asset remaining as of the beginning of the taxable year in which the increase or decrease in basis occurs, the applicable depreciation method and applicable convention for the increase or decrease in basis are the same depreciation method and convention applicable to the asset that applies for the taxable year in which the increase or decrease in basis occurs, and the increase or decrease in basis is deemed to be placed in service in the same taxable year as the asset.

(j) Identification of disposed or converted asset--(1) In general. The rules of this paragraph (j) apply when an asset in a general asset account is disposed of or converted in a transaction described in paragraph (e)(3)(iii) (disposition of an asset in a qualifying disposition), paragraph (e)(3)(iv)(B) (transactions subject to section 168(i)(7)),

paragraph (e)(3)(v)(B) (transactions subject to section 1031 or section 1033), paragraph (e)(3)(vii) (anti-abuse rule), paragraph (g) (assets subject to recapture), or paragraph (h)(1) (conversion to any personal use) of this section.

(2) Identifying which asset is disposed of or converted--(i) In general. For purposes of identifying which asset in a general asset account is disposed of or converted, a taxpayer must identify the disposed of or converted asset by using--

(A) The specific identification method of accounting. Under this method of accounting, the taxpayer can determine the particular taxable year in which the disposed of or converted asset was placed in service by the taxpayer;

(B) A first-in, first-out method of accounting if the taxpayer can readily determine from its records the total dispositions of assets with the same recovery period during the taxable year but the taxpayer cannot readily determine from its records the unadjusted depreciable basis of the disposed of or converted asset. Under this method of accounting, the taxpayer identifies the general asset account with the earliest placed-in-service year that has the same recovery period as the disposed of or converted asset and that has assets at the beginning of the taxable year of the disposition or conversion, and the taxpayer treats the disposed of or converted asset as being from that general asset account. To determine which general asset account has assets at the beginning of the taxable year of the disposition or conversion, the taxpayer reduces the number of assets originally included in the account by the number of assets disposed of or converted in any prior taxable year in a transaction to which this paragraph (j) applies;

(C) A modified first-in, first-out method of accounting if the taxpayer can readily determine from its records the total dispositions of assets with the same recovery period

during the taxable year and the unadjusted depreciable basis of the disposed of or converted asset. Under this method of accounting, the taxpayer identifies the general asset account with the earliest placed-in-service year that has the same recovery period as the disposed of or converted asset and that has assets at the beginning of the taxable year of the disposition or conversion with the same unadjusted depreciable basis as the disposed of or converted asset, and the taxpayer treats the disposed of or converted asset as being from that general asset account. To determine which general asset account has assets at the beginning of the taxable year of the disposition or conversion, the taxpayer reduces the number of assets originally included in the account by the number of assets disposed of or converted in any prior taxable year in a transaction to which this paragraph (j) applies;

(D) A mortality dispersion table if the asset is a mass asset accounted for in a separate general asset account in accordance with paragraph (c)(2)(ii)(H) of this section and if the taxpayer can readily determine from its records the total dispositions of assets with the same recovery period during the taxable year. The mortality dispersion table must be based upon an acceptable sampling of the taxpayer's actual disposition and conversion experience for mass assets or other acceptable statistical or engineering techniques. To use a mortality dispersion table, the taxpayer must adopt recordkeeping practices consistent with the taxpayer's prior practices and consonant with good accounting and engineering practices; or

(E) Any other method as the Secretary may designate by publication in the **Federal Register** or in the Internal Revenue Bulletin (see §601.601(d)(2) of this

chapter) on or after September 19, 2013. See paragraph (j)(2)(iii) of this section regarding the last-in, first-out method of accounting.

(ii) Disposition of a portion of an asset. If a taxpayer disposes of a portion of an asset and paragraph (e)(1)(ii) of this section applies to that disposition, the taxpayer may identify the asset by using any applicable method provided in paragraph (j)(2)(i) of this section, after taking into account paragraph (j)(2)(iii) of this section.

(iii) Last-in, first-out method of accounting. For purposes of paragraph (j)(2) of this section, a last-in, first-out method of accounting may not be used. Examples of a last-in, first-out method of accounting include the taxpayer identifying the general asset account with the most recent placed-in-service year that has the same recovery period as the disposed of or converted asset and that has assets at the beginning of the taxable year of the disposition or conversion, and the taxpayer treating the disposed of or converted asset as being from that general asset account, or the taxpayer treating the disposed portion of an asset as being from the general asset account with the most recent placed-in-service year that has assets that are the same as the asset of which the disposed portion is a part.

(3) Basis of disposed of or converted asset. (i) Solely for purposes of this paragraph (j)(3), the term asset is the asset as determined under paragraph (e)(2)(viii) of this section or the portion of such asset that is disposed of in a disposition described in paragraph (e)(1)(ii) of this section. After identifying which asset in a general asset account is disposed of or converted, the taxpayer must determine the unadjusted depreciable basis of, and the depreciation allowed or allowable for, the disposed of or converted asset. If it is impracticable from the taxpayer's records to determine the

unadjusted depreciable basis of the disposed of or converted asset, the taxpayer may use any reasonable method that is consistently applied to all assets in the same general asset account for purposes of determining the unadjusted depreciable basis of the disposed of or converted asset in that general asset account. Examples of a reasonable method include, but are not limited to, the following:

(A) If the replacement asset is a restoration (as defined in §1.263(a)-3(k)), and is not a betterment (as defined in §1.263(a)-3(j)) or an adaptation to a new or different use (as defined in §1.263(a)-3(l)), discounting the cost of the replacement asset to its placed-in-service year cost using the Producer Price Index for Finished Goods or its successor, the Producer Price Index for Final Demand, or any other index designated by guidance in the Internal Revenue Bulletin (see §601.601(d)(2) of this chapter) for purposes of this paragraph (j)(3);

(B) A pro rata allocation of the unadjusted depreciable basis of the general asset account based on the replacement cost of the disposed asset and the replacement cost of all of the assets in the general asset account; and

(C) A study allocating the cost of the asset to its individual components.

(ii) The depreciation allowed or allowable for the disposed of or converted asset is computed by using the depreciation method, recovery period, and convention applicable to the general asset account in which the disposed of or converted asset was included and by including the additional first year depreciation deduction claimed for the disposed of or converted asset.

(k) Effect of adjustments on prior dispositions. The adjustments to a general asset account under paragraph (e)(3)(iii), (e)(3)(iv), (e)(3)(v), (e)(3)(vii), (g), or (h) of this

section have no effect on the recognition and character of prior dispositions subject to paragraph (e)(2) of this section.

(l) Election--(1) Irrevocable election. If a taxpayer makes an election under this paragraph (l), the taxpayer consents to, and agrees to apply, all of the provisions of this section to the assets included in a general asset account. Except as provided in paragraph (c)(1)(ii)(A), (e)(3), (g), or (h) of this section or except as otherwise expressly provided by other guidance published in the Internal Revenue Bulletin (see §601.601(d)(2) of this chapter), an election made under this section is irrevocable and will be binding on the taxpayer for computing taxable income for the taxable year for which the election is made and for all subsequent taxable years. An election under this paragraph (l) is made separately by each person owning an asset to which this section applies (for example, by each member of a consolidated group, at the partnership level and not by the partner separately, or at the S corporation level and not by the shareholder separately).

\* \* \* \* \*

(m) Effective/applicability dates--(1) In general. This section applies to taxable years beginning on or after January 1, 2014. Except as provided in paragraphs (m)(2), (m)(3), and (m)(4) of this section, §1.168(i)-1 as contained in 26 CFR part 1 edition revised as of April 1, 2011, applies to taxable years beginning before January 1, 2014.

(2) Early application of this section. A taxpayer may choose to apply the provisions of this section to taxable years beginning on or after January 1, 2012.

(3) Early application of regulation project REG-110732-13. A taxpayer may rely on the provisions of this section in regulation project REG-110732-13 (2013-43 IRB

404) (see §601.601(d)(2) of this chapter) for taxable years beginning on or after January 1, 2012. However, a taxpayer may not rely on the provisions of this section in regulation project REG-110732-13 for taxable years beginning on or after January 1, 2014.

(4) Optional application of TD 9564. A taxpayer may choose to apply §1.168(i)-1T as contained in TD 9564 (76 FR 81060) December 27, 2011, to taxable years beginning on or after January 1, 2012. However, a taxpayer may not apply §1.168(i)-1T as contained in TD 9564 (76 FR 81060) December 27, 2011, to taxable years beginning on or after January 1, 2014.

(5) Change in method of accounting. A change to comply with this section for depreciable assets placed in service in a taxable year ending on or after December 30, 2003, is a change in method of accounting to which the provisions of section 446(e) and the regulations under section 446(e) apply. A taxpayer also may treat a change to comply with this section for depreciable assets placed in service in a taxable year ending before December 30, 2003, as a change in method of accounting to which the provisions of section 446(e) and the regulations under section 446(e) apply. This paragraph (m)(5) does not apply to a change to comply with paragraph (e)(3)(ii), (e)(3)(iii), or (l) of this section, except as otherwise expressly provided by other guidance published in the Internal Revenue Bulletin (see §601.601(d)(2) of this chapter).

### **§1.168(i)-1T [Removed]**

Par. 6. Section 1.168(i)-1T is removed.

Par. 7. Section 1.168(i)-7 is amended by revising the last sentence in paragraph (a) and revising paragraphs (b), (c)(2)(ii)(H), and (e) to read as follows:

§1.168(i)-7 Accounting for MACRS property.

(a) \* \* \* For rules applicable to general asset accounts, see §1.168(i)-1.

(b) Required use of single asset accounts. A taxpayer must account for an asset in a single asset account if the taxpayer uses the asset both in a trade or business or for the production of income and in a personal activity, or if the taxpayer places in service and disposes of the asset during the same taxable year. Also, if general asset account treatment for an asset terminates under §1.168(i)-1(c)(1)(ii)(A), (e)(3)(iii), (e)(3)(v), (e)(3)(vii), (g), or (h)(1), as applicable, the taxpayer must account for the asset in a single asset account beginning in the taxable year in which the general asset account treatment for the asset terminates. If a taxpayer accounts for an asset in a multiple asset account or a pool and the taxpayer disposes of the asset, the taxpayer must account for the asset in a single asset account beginning in the taxable year in which the disposition occurs. See §1.168(i)-8(h)(2)(i). If a taxpayer disposes of a portion of an asset and §1.168(i)-8(d)(1) applies to that disposition, the taxpayer must account for the disposed portion in a single asset account beginning in the taxable year in which the disposition occurs. See §1.168(i)-8(h)(3)(i).

(c) \* \* \*

(2) \* \* \*

(ii) \* \* \*

(H) Mass assets (as defined in §1.168(i)-8(b)(3)) that are or will be subject to §1.168(i)-8(g)(2)(iii) (disposed of or converted mass asset is identified by a mortality dispersion table) must be grouped into a separate multiple asset account or pool.

\* \* \* \* \*

(e) Effective/applicability dates--(1) In general. This section applies to taxable years beginning on or after January 1, 2014.

(2) Early application of this section. A taxpayer may choose to apply the provisions of this section to taxable years beginning on or after January 1, 2012.

(3) Early application of regulation project REG-110732-13. A taxpayer may rely on the provisions of this section in regulation project REG-110732-13 (2013-43 IRB 404) (see §601.601(d)(2) of this chapter) for taxable years beginning on or after January 1, 2012. However, a taxpayer may not rely on the provisions of this section in regulation project REG-110732-13 for taxable years beginning on or after January 1, 2014.

(4) Optional application of TD 9564. A taxpayer may choose to apply §1.168(i)-7T as contained in TD 9564 (76 FR 81060) December 27, 2011, to taxable years beginning on or after January 1, 2012. However, a taxpayer may not apply §1.168(i)-7T as contained in TD 9564 (76 FR 81060) December 27, 2011, to taxable years beginning on or after January 1, 2014.

(5) Change in method of accounting. A change to comply with this section for depreciable assets placed in service in a taxable year ending on or after December 30, 2003, is a change in method of accounting to which the provisions of section 446(e) and the regulations under section 446(e) apply. A taxpayer also may treat a change to

comply with this section for depreciable assets placed in service in a taxable year ending before December 30, 2003, as a change in method of accounting to which the provisions of section 446(e) and the regulations under section 446(e) apply.

Par. 8. Section 1.168(i)-8 is added to read as follows:

§1.168(i)-8 Dispositions of MACRS property.

(a) Scope. This section provides rules applicable to dispositions of MACRS property (as defined in §1.168(b)-1(a)(2)) or to depreciable property (as defined in §1.168(b)-1(a)(1)) that would be MACRS property but for an election made by the taxpayer either to expense all or some of the property's cost under section 179, section 179A, section 179B, section 179C, section 179D, or section 1400l(a)(1), or any similar provision, or to amortize all or some of the property's cost under section 1400l(a)(2) or any similar provision. This section also applies to dispositions described in paragraph (d)(1) of this section of a portion of such property. Except as provided in §1.168(i)-1(e)(3), this section does not apply to dispositions of assets included in a general asset account. For rules applicable to dispositions of assets included in a general asset account, see §1.168(i)-1(e).

(b) Definitions. For purposes of this section--

(1) Building has the same meaning as that term is defined in §1.48-1(e)(1).

(2) Disposition occurs when ownership of the asset is transferred or when the asset is permanently withdrawn from use either in the taxpayer's trade or business or in the production of income. A disposition includes the sale, exchange, retirement, physical abandonment, or destruction of an asset. A disposition also occurs when an asset is transferred to a supplies, scrap, or similar account, or when a portion of an

asset is disposed of as described in paragraph (d)(1) of this section. If a structural component, or a portion thereof, of a building is disposed of in a disposition described in paragraph (d)(1) of this section, a disposition also includes the disposition of such structural component or such portion thereof.

(3) Mass assets is a mass or group of individual items of depreciable assets--

- (i) That are not necessarily homogenous;
- (ii) Each of which is minor in value relative to the total value of the mass or group;
- (iii) Numerous in quantity;
- (iv) Usually accounted for only on a total dollar or quantity basis;
- (v) With respect to which separate identification is impracticable; and
- (vi) Placed in service in the same taxable year.

(4) Portion of an asset is any part of an asset that is less than the entire asset as determined under paragraph (c)(4) of this section.

(5) Structural component has the same meaning as that term is defined in §1.48-1(e)(2).

(6) Unadjusted depreciable basis of the multiple asset account or pool is the sum of the unadjusted depreciable bases (as defined in §1.168(b)-1(a)(3)) of all assets included in the multiple asset account or pool.

(c) Special rules--(1) Manner of disposition. The manner of disposition (for example, normal retirement, abnormal retirement, ordinary retirement, or extraordinary retirement) is not taken into account in determining whether a disposition occurs or gain or loss is recognized.

(2) Disposition by transfer to a supplies account. If a taxpayer made an election under §1.162-3(d) to treat the cost of any rotatable spare part, temporary spare part, or standby emergency spare part (as defined in §1.162-3(c)) as a capital expenditure subject to the allowance for depreciation, the taxpayer can dispose of the rotatable, temporary, or standby emergency spare part by transferring it to a supplies account only if the taxpayer has obtained the consent of the Commissioner to revoke the §1.162-3(d) election. If a taxpayer made an election under §1.162-3T(d) to treat the cost of any material and supply (as defined in §1.162-3T(c)(1)) as a capital expenditure subject to the allowance for depreciation, the taxpayer can dispose of the material and supply by transferring it to a supplies account only if the taxpayer has obtained the consent of the Commissioner to revoke the §1.162-3T(d) election. See §1.162-3(d)(3) for the procedures for revoking a §1.162-3(d) or a §1.162-3T(d) election.

(3) Leasehold improvements. This section also applies to--

(i) A lessor of leased property that made an improvement to that property for the lessee of the property, has a depreciable basis in the improvement, and disposes of the improvement, or disposes of a portion of the improvement under paragraph (d)(1) of this section, before or upon the termination of the lease with the lessee. See section 168(i)(8)(B); and

(ii) A lessee of leased property that made an improvement to that property, has a depreciable basis in the improvement, and disposes of the improvement, or disposes of a portion of the improvement under paragraph (d)(1) of this section, before or upon the termination of the lease.

(4) Determination of asset disposed of--(i) General rules. For purposes of applying this section, the facts and circumstances of each disposition are considered in determining what is the appropriate asset disposed of. The asset for disposition purposes may not consist of items placed in service by the taxpayer on different dates, without taking into account the applicable convention. For purposes of determining what is the appropriate asset disposed of, the unit of property determination under §1.263(a)-3(e) or in published guidance in the Internal Revenue Bulletin (see §601.601(d)(2) of this chapter) under section 263(a) does not apply.

(ii) Special rules. In addition to the general rules in paragraph (c)(4)(i) of this section, the following rules apply for purposes of applying this section:

(A) Each building, including its structural components, is the asset, except as provided in §1.1250-1(a)(2)(ii) or in paragraph (c)(4)(ii)(B) or (D) of this section.

(B) If a building has two or more condominium or cooperative units, each condominium or cooperative unit, including its structural components, is the asset, except as provided in §1.1250-1(a)(2)(ii) or in paragraph (c)(4)(ii)(D) of this section.

(C) If a taxpayer properly includes an item in one of the asset classes 00.11 through 00.4 of Rev. Proc. 87-56 (1987-2 CB 674) (see §601.601(d)(2) of this chapter) or properly classifies an item in one of the categories under section 168(e)(3), except for a category that includes buildings or structural components (for example, retail motor fuels outlet, qualified leasehold improvement property, qualified restaurant property, and qualified retail improvement property), each item is the asset provided paragraph (c)(4)(ii)(D) of this section does not apply to the item. For example, each desk is the asset, each computer is the asset, and each qualified smart electric meter is the asset.

(D) 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 and, if applicable, its structural components are a separate asset.

(d) Disposition of a portion of an asset--(1) In general. For purposes of applying this section, a disposition includes a disposition of a portion of an asset as a result of a casualty event described in section 165, a disposition of a portion of an asset for which gain, determined without regard to section 1245 or section 1250, is not recognized in whole or in part under section 1031 or section 1033, a transfer of a portion of an asset in a transaction described in section 168(i)(7)(B), or a sale of a portion of an asset, even if the taxpayer does not make the election under paragraph (d)(2)(i) of this section for that disposed portion. For other transactions, a disposition includes a disposition of a portion of an asset only if the taxpayer makes the election under paragraph (d)(2)(i) of this section for that disposed portion.

(2) Partial disposition election--(i) In general. A taxpayer may make an election under this paragraph (d)(2) to apply this section to a disposition of a portion of an asset. If the asset is properly included in one of the asset classes 00.11 through 00.4 of Rev. Proc. 87-56, a taxpayer may make an election under this paragraph (d)(2) to apply this section to a disposition of a portion of such asset only if the taxpayer classifies the replacement portion of the asset under the same asset class as the disposed portion of the asset.

(ii) Time and manner for making election--(A) Time for making election. Except as provided in paragraph (d)(2)(iii) or (iv) of this section, a taxpayer must make the election specified in paragraph (d)(2)(i) of this section by the due date, including

extensions, of the original Federal tax return for the taxable year in which the portion of an asset is disposed of by the taxpayer.

(B) Manner of making election. Except as provided in paragraph (d)(2)(iii) or (iv) of this section, a taxpayer must make the election specified in paragraph (d)(2)(i) of this section by applying the provisions of this section for the taxable year in which the portion of an asset is disposed of by the taxpayer, by reporting the gain, loss, or other deduction on the taxpayer's timely filed, including extensions, original Federal tax return for that taxable year, and, if the asset is properly included in one of the asset classes 00.11 through 00.4 of Rev. Proc. 87-56, by classifying the replacement portion of such asset under the same asset class as the disposed portion of the asset in the taxable year in which the replacement portion is placed in service by the taxpayer. Except as provided in paragraph (d)(2)(iii) or (iv)(B) of this section or except as otherwise expressly provided by other guidance published in the Internal Revenue Bulletin (see §601.601(d)(2) of this chapter), the election specified in paragraph (d)(2)(i) of this section may not be made through the filing of an application for change in accounting method.

(iii) Special rule for subsequent Internal Revenue Service adjustment. This paragraph (d)(2)(iii) applies when a taxpayer deducted the amount paid or incurred for the replacement of a portion of an asset as a repair under §1.162-4, the taxpayer did not make the election specified in paragraph (d)(2)(i) of this section for the disposed portion of that asset within the time and in the manner under paragraph (d)(2)(ii) or (iv) of this section, and as a result of an examination of the taxpayer's Federal tax return, the Internal Revenue Service disallows the taxpayer's repair deduction for the amount

paid or incurred for the replacement of the portion of that asset and instead capitalizes such amount under §1.263(a)-2 or §1.263(a)-3. If this paragraph (d)(2)(iii) applies, the taxpayer may make the election specified in paragraph (d)(2)(i) of this section for the disposition of the portion of the asset to which the Internal Revenue Service's adjustment pertains by filing an application for change in accounting method, provided the asset of which the disposed portion was a part is owned by the taxpayer at the beginning of the year of change (as defined for purposes of section 446(e)).

(iv) Special rules for 2012 or 2013 returns. If, under paragraph (j)(2) of this section, a taxpayer chooses to apply the provisions of this section to a taxable year beginning on or after January 1, 2012, and ending on or before September 19, 2013 (applicable taxable year), and the taxpayer did not make the election specified in paragraph (d)(2)(i) of this section on its timely filed original Federal tax return for the applicable taxable year, including extensions, the taxpayer must make the election specified in paragraph (d)(2)(i) of this section for the applicable taxable year by filing either--

(A) An amended Federal tax return for the applicable taxable year on or before 180 days from the due date including extensions of the taxpayer's Federal tax return for the applicable taxable year, notwithstanding that the taxpayer may not have extended the due date; or

(B) An application for change in accounting method with the taxpayer's timely filed original Federal tax return for the first or second taxable year succeeding the applicable taxable year.

(v) Revocation. A taxpayer may revoke the election specified in paragraph (d)(2)(i) of this section only by filing a request for a private letter ruling and obtaining the Commissioner's consent to revoke the election. The Commissioner may grant a request to revoke this election if the taxpayer acted reasonably and in good faith, and the revocation will not prejudice the interests of the Government. See generally §301.9100-3 of this chapter. The election specified in paragraph (d)(2)(i) of this section may not be revoked through the filing of an application for change in accounting method.

(e) Gain or loss on dispositions. Solely for purposes of this paragraph (e), the term asset is an asset within the scope of this section or the portion of such asset that is disposed of in a disposition described in paragraph (d)(1) of this section. Except as provided by section 280B and §1.280B-1, the following rules apply when an asset is disposed of during a taxable year:

(1) If an asset is disposed of by sale, exchange, or involuntary conversion, gain or loss must be recognized under the applicable provisions of the Internal Revenue Code.

(2) If an asset is disposed of by physical abandonment, loss must be recognized in the amount of the adjusted depreciable basis (as defined in §1.168(b)-1(a)(4)) of the asset at the time of the abandonment, taking into account the applicable convention. However, if the abandoned asset is subject to nonrecourse indebtedness, paragraph (e)(1) of this section applies to the asset instead of this paragraph (e)(2). For a loss from physical abandonment to qualify for recognition under this paragraph (e)(2), the

taxpayer must intend to discard the asset irrevocably so that the taxpayer will neither use the asset again nor retrieve it for sale, exchange, or other disposition.

(3) If an asset is disposed of other than by sale, exchange, involuntary conversion, physical abandonment, or conversion to personal use (as, for example, when the asset is transferred to a supplies or scrap account), gain is not recognized. Loss must be recognized in the amount of the excess of the adjusted depreciable basis of the asset at the time of the disposition, taking into account the applicable convention, over the asset's fair market value at the time of the disposition, taking into account the applicable convention.

(f) Basis of asset disposed of--(1) In general. The adjusted basis of an asset disposed of for computing gain or loss is its adjusted depreciable basis at the time of the asset's disposition, as determined under the applicable convention for the asset.

(2) Assets disposed of are in multiple asset accounts. (i) If the taxpayer accounts for the asset disposed of in a multiple asset account or pool and it is impracticable from the taxpayer's records to determine the unadjusted depreciable basis (as defined in §1.168(b)-1(a)(3)) of the asset disposed of, the taxpayer may use any reasonable method that is consistently applied to all assets in the same multiple asset account or pool for purposes of determining the unadjusted depreciable basis of assets disposed of. Examples of a reasonable method include, but are not limited to, the following:

(A) If the replacement asset is a restoration (as defined in §1.263(a)-3(k)), and is not a betterment (as defined in §1.263(a)-3(j)) or an adaptation to a new or different use (as defined in §1.263(a)-3(l)), discounting the cost of the replacement asset to its placed-in-service year cost using the Producer Price Index for Finished Goods or its

successor, the Producer Price Index for Final Demand, or any other index designated by guidance in the Internal Revenue Bulletin (see §601.601(d)(2) of this chapter) for purposes of this paragraph (f)(2);

(B) A pro rata allocation of the unadjusted depreciable basis of the multiple asset account or pool based on the replacement cost of the disposed asset and the replacement cost of all of the assets in the multiple asset account or pool; and

(C) A study allocating the cost of the asset to its individual components.

(ii) To determine the adjusted depreciable basis of an asset disposed of in a multiple asset account or pool, the depreciation allowed or allowable for the asset disposed of is computed by using the depreciation method, recovery period, and convention applicable to the multiple asset account or pool in which the asset disposed of was included and by including the additional first year depreciation deduction claimed for the asset disposed of.

(3) Disposition of a portion of an asset. (i) This paragraph (f)(3) applies only when a taxpayer disposes of a portion of an asset and paragraph (d)(1) of this section applies to that disposition. For computing gain or loss, the adjusted basis of the disposed portion of the asset is the adjusted depreciable basis of that disposed portion at the time of its disposition, as determined under the applicable convention for the asset. If it is impracticable from the taxpayer's records to determine the unadjusted depreciable basis (as defined in §1.168(b)-1(a)(3)) of the disposed portion of the asset, the taxpayer may use any reasonable method for purposes of determining the unadjusted depreciable basis (as defined in §1.168(b)-1(a)(3)) of the disposed portion of the asset. If a taxpayer disposes of more than one portion of the same asset and it is

impracticable from the taxpayer's records to determine the unadjusted depreciable basis (as defined in §1.168(b)-1(a)(3)) of the first disposed portion of the asset, the reasonable method used by the taxpayer must be consistently applied to all portions of the same asset for purposes of determining the unadjusted depreciable basis of each disposed portion of the asset. If the asset, a portion of which is disposed of, is in a multiple asset account or pool and it is impracticable from the taxpayer's records to determine the unadjusted depreciable basis (as defined in §1.168(b)-1(a)(3)) of the disposed portion of the asset, the reasonable method used by the taxpayer must be consistently applied to all assets in the same multiple asset account or pool for purposes of determining the unadjusted depreciable basis of assets disposed of or any disposed portion of the assets. Examples of a reasonable method include, but are not limited to, the following:

(A) If the replacement portion is a restoration (as defined in §1.263(a)-3(k)), and is not a betterment (as defined in §1.263(a)-3(j)) or an adaptation to a new or different use (as defined in §1.263(a)-3(l)), discounting the cost of the replacement portion of the asset to its placed-in-service year cost using the Producer Price Index for Finished Goods or its successor, the Producer Price Index for Final Demand, or any other index designated by guidance in the Internal Revenue Bulletin (see §601.601(d)(2) of this chapter) for purposes of this paragraph (f)(3);

(B) A pro rata allocation of the unadjusted depreciable basis of the asset based on the replacement cost of the disposed portion of the asset and the replacement cost of the asset; and

(C) A study allocating the cost of the asset to its individual components.

(ii) To determine the adjusted depreciable basis of the disposed portion of the asset, the depreciation allowed or allowable for the disposed portion is computed by using the depreciation method, recovery period, and convention applicable to the asset in which the disposed portion was included and by including the portion of the additional first year depreciation deduction claimed for the asset that is attributable to the disposed portion.

(g) Identification of asset disposed of--(1) In general. Except as provided in paragraph (g)(2) or (3) of this section, a taxpayer must use the specific identification method of accounting to identify which asset is disposed of by the taxpayer. Under this method of accounting, the taxpayer can determine the particular taxable year in which the asset disposed of was placed in service by the taxpayer.

(2) Asset disposed of is in a multiple asset account. If a taxpayer accounts for the asset disposed of in a multiple asset account or pool and the total dispositions of assets with the same recovery period during the taxable year are readily determined from the taxpayer's records, but it is impracticable from the taxpayer's records to determine the particular taxable year in which the asset disposed of was placed in service by the taxpayer, the taxpayer must identify the asset disposed of by using--

(i) A first-in, first-out method of accounting if the unadjusted depreciable basis of the asset disposed of cannot be readily determined from the taxpayer's records. Under this method of accounting, the taxpayer identifies the multiple asset account or pool with the earliest placed-in-service year that has the same recovery period as the asset disposed of and that has assets at the beginning of the taxable year of the disposition,

and the taxpayer treats the asset disposed of as being from that multiple asset account or pool;

(ii) A modified first-in, first-out method of accounting if the unadjusted depreciable basis of the asset disposed of can be readily determined from the taxpayer's records. Under this method of accounting, the taxpayer identifies the multiple asset account or pool with the earliest placed-in-service year that has the same recovery period as the asset disposed of and that has assets at the beginning of the taxable year of the disposition with the same unadjusted depreciable basis as the asset disposed of, and the taxpayer treats the asset disposed of as being from that multiple asset account or pool;

(iii) A mortality dispersion table if the asset disposed of is a mass asset. The mortality dispersion table must be based upon an acceptable sampling of the taxpayer's actual disposition experience for mass assets or other acceptable statistical or engineering techniques. To use a mortality dispersion table, the taxpayer must adopt recordkeeping practices consistent with the taxpayer's prior practices and consonant with good accounting and engineering practices; or

(iv) Any other method as the Secretary may designate by publication in the **Federal Register** or in the Internal Revenue Bulletin (see §601.601(d)(2) of this chapter) on or after September 19, 2013. See paragraph (g)(4) of this section regarding the last-in, first-out method of accounting.

(3) Disposition of a portion of an asset. If a taxpayer disposes of a portion of an asset and paragraph (d)(1) of this section applies to that disposition, but it is impracticable from the taxpayer's records to determine the particular taxable year in

which the asset was placed in service, the taxpayer must identify the asset by using any applicable method provided in paragraph (g)(2) of this section, after taking into account paragraph (g)(4) of this section.

(4) Last-in, first-out method of accounting. For purposes of this paragraph (g), a last-in, first-out method of accounting may not be used. Examples of a last-in, first-out method of accounting include the taxpayer identifying the multiple asset account or pool with the most recent placed-in-service year that has the same recovery period as the asset disposed of and that has assets at the beginning of the taxable year of the disposition, and the taxpayer treating the asset disposed of as being from that multiple asset account or pool, or the taxpayer treating the disposed portion of an asset as being from an asset with the most recent placed-in-service year that is the same as the asset of which the disposed portion is a part.

(h) Accounting for asset disposed of--(1) Depreciation ends. Depreciation ends for an asset at the time of the asset's disposition, as determined under the applicable convention for the asset. See §1.167(a)-10(b). If the asset disposed of is in a single asset account initially or as a result of §1.168(i)-8(h)(2)(i), §1.168(i)-8(h)(3)(i), or general asset account treatment for the asset terminated under §1.168(i)-1(c)(1)(ii)(A), (e)(3)(iii), (e)(3)(v), (e)(3)(vii), (g), or (h)(1), as applicable, the single asset account terminates at the time of the asset's disposition, as determined under the applicable convention for the asset. If a taxpayer disposes of a portion of an asset and paragraph (d)(1) of this section applies to that disposition, depreciation ends for that disposed portion of the asset at the time of the disposition of the disposed portion, as determined under the applicable convention for the asset.

(2) Asset disposed of in a multiple asset account or pool. If the taxpayer accounts for the asset disposed of in a multiple asset account or pool, then--

(i) As of the first day of the taxable year in which the disposition occurs, the asset disposed of is removed from the multiple asset account or pool and is placed into a single asset account. See §1.168(i)-7(b);

(ii) The unadjusted depreciable basis of the multiple asset account or pool must be reduced by the unadjusted depreciable basis of the asset disposed of as of the first day of the taxable year in which the disposition occurs. See paragraph (f)(2)(i) of this section for determining the unadjusted depreciable basis of the asset disposed of;

(iii) The depreciation reserve of the multiple asset account or pool must be reduced by the depreciation allowed or allowable for the asset disposed of as of the end of the taxable year immediately preceding the year of disposition, computed by using the depreciation method, recovery period, and convention applicable to the multiple asset account or pool in which the asset disposed of was included and by including the additional first year depreciation deduction claimed for the asset disposed of; and

(iv) In determining the adjusted depreciable basis of the asset disposed of at the time of disposition, taking into account the applicable convention, the depreciation allowed or allowable for the asset disposed of is computed by using the depreciation method, recovery period, and convention applicable to the multiple asset account or pool in which the asset disposed of was included and by including the additional first year depreciation deduction claimed for the asset disposed of.

(3) Disposition of a portion of an asset. This paragraph (h)(3) applies only when a taxpayer disposes of a portion of an asset and paragraph (d)(1) of this section applies to that disposition. In this case--

(i) As of the first day of the taxable year in which the disposition occurs, the disposed portion is placed into a single asset account. See §1.168(i)-7(b);

(ii) The unadjusted depreciable basis of the asset must be reduced by the unadjusted depreciable basis of the disposed portion as of the first day of the taxable year in which the disposition occurs. See paragraph (f)(3)(i) of this section for determining the unadjusted depreciable basis of the disposed portion;

(iii) The depreciation reserve of the asset must be reduced by the depreciation allowed or allowable for the disposed portion as of the end of the taxable year immediately preceding the year of disposition, computed by using the depreciation method, recovery period, and convention applicable to the asset in which the disposed portion was included and by including the portion of the additional first year depreciation deduction claimed for the asset that is attributable to the disposed portion; and

(iv) In determining the adjusted depreciable basis of the disposed portion at the time of disposition, taking into account the applicable convention, the depreciation allowed or allowable for the disposed portion is computed by using the depreciation method, recovery period, and convention applicable to the asset in which the disposed portion was included and by including the portion of the additional first year depreciation deduction claimed for the asset that is attributable to the disposed portion.

(i) Examples. The application of this section is illustrated by the following examples:

Example 1. A owns an office building with four elevators. A replaces one of the elevators. The elevator is a structural component of the office building. In accordance with paragraph (c)(4)(ii)(A) of this section, the office building, including its structural components, is the asset for disposition purposes. A does not make the partial disposition election provided under paragraph (d)(2) of this section for the elevator. Thus, the retirement of the replaced elevator is not a disposition. As a result, depreciation continues for the cost of the building, including the cost of the retired elevator and the building's other structural components, and A does not recognize a loss for this retired elevator. If A must capitalize the amount paid for the replacement elevator pursuant to §1.263(a)-3, the replacement elevator is a separate asset for disposition purposes pursuant to paragraph (c)(4)(ii)(D) of this section and for depreciation purposes pursuant to section 168(i)(6).

Example 2. The facts are the same as in Example 1, except A accounts for each structural component of the office building as a separate asset in its fixed asset system. Although A treats each structural component as a separate asset in its records, the office building, including its structural components, is the asset for disposition purposes in accordance with paragraph (c)(4)(ii)(A) of this section. Accordingly, the result is the same as in Example 1.

Example 3. The facts are the same as in Example 1, except A makes the partial disposition election provided under paragraph (d)(2) of this section for the elevator. Although the office building, including its structural components, is the asset for disposition purposes, the result of A making the partial disposition election for the elevator is that the retirement of the replaced elevator is a disposition. Thus, depreciation for the retired elevator ceases at the time of its retirement, taking into account the applicable convention, and A recognizes a loss upon this retirement. Further, A must capitalize the amount paid for the replacement elevator pursuant to §1.263(a)-3(k)(1)(i), and the replacement elevator is a separate asset for disposition purposes pursuant to paragraph (c)(4)(ii)(D) of this section and for depreciation purposes pursuant to section 168(i)(6).

Example 4. B, a calendar-year commercial airline company, owns several aircraft that are used in the commercial carrying of passengers and described in asset class 45.0 of Rev. Proc. 87-56. B replaces the existing engines on one of the aircraft with new engines. Assume each aircraft is a unit of property as determined under §1.263(a)-3(e)(3) and each engine of an aircraft is a major component or substantial structural part of the aircraft as determined under §1.263(a)-3(k)(6). Assume also that B treats each aircraft as the asset for disposition purposes in accordance with paragraph (c)(4) of this section. B makes the partial disposition election provided under paragraph (d)(2) of this section for the engines in the aircraft. Although the aircraft is the asset for disposition purposes, the result of B making the partial disposition election for the engines is that the retirement of the replaced engines is a disposition. Thus, depreciation for the retired engines ceases at the time of their retirement, taking into account the applicable convention, and B recognizes a loss upon this retirement. Further, B must capitalize the amount paid for the replacement engines pursuant to

§1.263(a)-3(k)(1)(i), and the replacement engines are a separate asset for disposition purposes pursuant to paragraph (c)(4)(ii)(D) of this section and for depreciation purposes pursuant to section 168(i)(6).

Example 5. The facts are the same as in Example 4, except B does not make the partial disposition election provided under paragraph (d)(2) of this section for the engines. Thus, the retirement of the replaced engines on one of the aircraft is not a disposition. As a result, depreciation continues for the cost of the aircraft, including the cost of the retired engines, and B does not recognize a loss for these retired engines. If B must capitalize the amount paid for the replacement engines pursuant to §1.263(a)-3, the replacement engines are a separate asset for disposition purposes pursuant to paragraph (c)(4)(ii)(D) of this section and for depreciation purposes pursuant to section 168(i)(6).

Example 6. C, a corporation, owns several trucks that are used in its trade or business and described in asset class 00.241 of Rev. Proc. 87-56. C replaces the engine on one of the trucks with a new engine. Assume each truck is a unit of property as determined under §1.263(a)-3(e)(3) and each engine is a major component or substantial structural part of the truck as determined under §1.263(a)-3(k)(6). Because the trucks are described in asset class 00.241 of Rev. Proc. 87-56, C must treat each truck as the asset for disposition purposes. C does not make the partial disposition election provided under paragraph (d)(2) of this section for the engine. Thus, the retirement of the replaced engine on the truck is not a disposition. As a result, depreciation continues for the cost of the truck, including the cost of the retired engine, and C does not recognize a loss for this retired engine. If C must capitalize the amount paid for the replacement engine pursuant to §1.263(a)-3, the replacement engine is a separate asset for disposition purposes pursuant to paragraph (c)(4)(ii)(D) of this section and for depreciation purposes pursuant to section 168(i)(6).

Example 7. D owns a retail building. D replaces 60% of the roof of this building. In accordance with paragraph (c)(4)(ii)(A) of this section, the retail building, including its structural components, is the asset for disposition purposes. Assume D must capitalize the costs incurred for replacing 60% of the roof pursuant to §1.263(a)-3(k)(1)(vi). D makes the partial disposition election provided under paragraph (d)(2) of this section for the 60% of the replaced roof. Thus, the retirement of 60% of the roof is a disposition. As a result, depreciation for 60% of the roof ceases at the time of its retirement, taking into account the applicable convention, and D recognizes a loss upon this retirement. Further, D must capitalize the amount paid for the 60% of the roof pursuant to §1.263(a)-3(k)(1)(i) and (vi) and the replacement 60% of the roof is a separate asset for disposition purposes pursuant to paragraph (c)(4)(ii)(D) of this section and for depreciation purposes pursuant to section 168(i)(6).

Example 8. (i) The facts are the same as in Example 7. Ten years after replacing 60% of the roof, D replaces 55% of the roof of the building. In accordance with paragraph (c)(4)(ii)(A) and (D) of this section, for disposition purposes, the retail building, including its structural components, except the replacement 60% of the roof, is

an asset and the replacement 60% of the roof is a separate asset. Assume D must capitalize the costs incurred for replacing 55% of the roof pursuant to §1.263(a)-3(k)(1)(vi). D makes the partial disposition election provided under paragraph (d)(2) of this section for the 55% of the replaced roof. Thus, the retirement of 55% of the roof is a disposition.

(ii) However, D cannot determine from its records whether the replaced 55% is part of the 60% of the roof replaced ten years ago or whether the replaced 55% includes part or all of the remaining 40% of the original roof. Pursuant to paragraph (g)(3) of this section, D identifies which asset it disposed of by using the first-in, first-out method of accounting. As a result, D disposed of the remaining 40% of the original roof and 25% of the 60% of the roof replaced ten years ago.

(iii) Thus, depreciation for the remaining 40% of the original roof ceases at the time of its retirement, taking into account the applicable convention, and D recognizes a loss upon this retirement. Further, depreciation for 25% of the 60% of the roof replaced ten years ago ceases at the time of its retirement, taking into account the applicable convention, and D recognizes a loss upon this retirement. Also, D must capitalize the amount paid for the 55% of the roof pursuant to §1.263(a)-3(k)(1)(i) and (vi), and the replacement 55% of the roof is a separate asset for disposition purposes pursuant to paragraph (c)(4)(ii)(D) of this section and for depreciation purposes pursuant to section 168(i)(6).

Example 9. (i) On July 1, 2011, E, a calendar-year taxpayer, purchased and placed in service an existing multi-story office building that costs \$20,000,000. The cost of each structural component of the building was not separately stated. E accounts for the building and its structural components in its tax and financial accounting records as a single asset with a cost of \$20,000,000. E depreciates the building as nonresidential real property and uses the optional depreciation table that corresponds with the general depreciation system, the straight-line method, a 39-year recovery period, and the mid-month convention. As of January 1, 2014, the depreciation reserve for the building is \$1,261,000.

(ii) On June 30, 2014, E replaces one of the two elevators in the office building. E did not dispose of any other structural components of this building in 2014 and prior years. E makes the partial disposition election provided under paragraph (d)(2) of this section for this elevator. Although the office building, including its structural components, is the asset for disposition purposes, the result of E making the partial disposition election for the elevator is that the retirement of the replaced elevator is a disposition. Assume the replacement elevator is a restoration under §1.263(a)-3(k), and not a betterment under §1.263(a)-3(j) or an adaptation to a new or different use under §1.263(a)-3(l). Because E cannot identify the cost of the elevator from its records and the replacement elevator is a restoration under §1.263(a)-3(k), E determines the cost of the disposed elevator by discounting the cost of the replacement elevator to its placed-in-service year cost using the Producer Price Index for Final Demand. Using this reasonable method, E determines the cost of the retired elevator by discounting the cost

of the replacement elevator to its cost in 2011 (the placed-in-service year) using the Producer Price Index for Final Demand, resulting in \$150,000 of the \$20,000,000 purchase price for the building to be the cost of the retired elevator. Using the optional depreciation table that corresponds with the general depreciation system, the straight-line method, a 39-year recovery period, and the mid-month convention, the depreciation allowed or allowable for the retired elevator as of December 31, 2013, is \$9,458.

(iii) For E's 2014 Federal tax return, the loss for the retired elevator is determined as follows. The depreciation allowed or allowable for 2014 for the retired elevator is \$1,763 ((unadjusted depreciable basis of \$150,000 x depreciation rate of 2.564% for 2014) x 5.5/12 months). Thus, the adjusted depreciable basis of the retired elevator is \$138,779 (the adjusted depreciable basis of \$140,542 removed from the building cost less the depreciation allowed or allowable of \$1,763 for 2014). As a result, E recognizes a loss of \$138,779 for the retired elevator in 2014.

(iv) For E's 2014 Federal tax return, the depreciation allowance for the building is computed as follows. As of January 1, 2014, the unadjusted depreciable basis of the building is reduced from \$20,000,000 to \$19,850,000 (\$20,000,000 less the unadjusted depreciable basis of \$150,000 for the retired elevator), and the depreciation reserve of the building is reduced from \$1,261,000 to \$1,251,542 (\$1,261,000 less the depreciation allowed or allowable of \$9,458 for the retired elevator as of December 31, 2013). Consequently, the depreciation allowance for the building for 2014 is \$508,954 (\$19,850,000 x depreciation rate of 2.564% for 2014).

(v) E also must capitalize the amount paid for the replacement elevator pursuant to §1.263(a)-3(k)(1). The replacement elevator is a separate asset for disposition purposes pursuant to paragraph (c)(4)(ii)(D) of this section and for depreciation purposes pursuant to section 168(i)(6).

Example 10. (i) Since 2005, F, a calendar year taxpayer, has accounted for items of MACRS property that are mass assets in pools. Each pool includes only the mass assets that have the same depreciation method, recovery period, and convention, and are placed in service by F in the same taxable year. None of the pools are general asset accounts under section 168(i)(4) and the regulations under section 168(i)(4). F identifies any dispositions of these mass assets by specific identification.

(ii) During 2014, F sells 10 items of mass assets with a 5-year recovery period each for \$100. Under the specific identification method, F identifies these mass assets as being from the pool established by F in 2012 for mass assets with a 5-year recovery period. Assume F depreciates this pool using the optional depreciation table that corresponds with the general depreciation system, the 200-percent declining balance method, a 5-year recovery period, and the half-year convention. F elected not to deduct the additional first year depreciation provided by section 168(k) for 5-year property placed in service during 2012. As of January 1, 2014, this pool contains 100 similar items of mass assets with a total cost of \$25,000 and a total depreciation reserve of \$13,000. Because all the items of mass assets in the pool are similar, F allocates the

cost and depreciation allowed or allowable for the pool ratably among each item in the pool. This allocation is a reasonable method because all the items of mass assets in the pool are similar. Using this reasonable method, F allocates a cost of \$250 ( $\$25,000 \times (1/100)$ ) to each disposed of mass asset and depreciation allowed or allowable of \$130 ( $\$13,000 \times (1/100)$ ) to each disposed of mass asset. The depreciation allowed or allowable in 2014 for each disposed of mass asset is \$24 ( $(\$250 \times 19.2\%) / 2$ ). As a result, the adjusted depreciable basis of each disposed of mass asset under section 1011 is \$96 ( $\$250 - \$130 - \$24$ ). Thus, F recognizes a gain of \$4 for each disposed of mass asset in 2014, which is subject to section 1245.

(iii) Further, as of January 1, 2014, the unadjusted depreciable basis of the 2012 pool of mass assets with a 5-year recovery period is reduced from \$25,000 to \$22,500 ( $\$25,000$  less the unadjusted depreciable basis of \$2,500 for the 10 disposed of items), and the depreciation reserve of this 2012 pool is reduced from \$13,000 to \$11,700 ( $\$13,000$  less the depreciation allowed or allowable of \$1,300 for the 10 disposed of items as of December 31, 2013). Consequently, as of January 1, 2014, the 2012 pool of mass assets with a 5-year recovery period has 90 items with a total cost of \$22,500 and a depreciation reserve of \$11,700. Thus, the depreciation allowance for this pool for 2014 is \$4,320 ( $\$22,500 \times 19.2\%$ ).

Example 11. (i) The facts are the same as in Example 10. Because of changes in F's recordkeeping in 2015, it is impracticable for F to continue to identify disposed of mass assets using specific identification and to determine the unadjusted depreciable basis of the disposed of mass assets. As a result, F files a Form 3115, Application for Change in Accounting Method, to change to a first-in, first-out method beginning with the taxable year beginning on January 1, 2015, on a modified cut-off basis. See §1.446-1(e)(2)(ii)(d)(2)(vii). Under the first-in, first-out method, the mass assets disposed of in a taxable year are deemed to be from the pool with the earliest placed-in-service year that has assets as of the beginning of the taxable year of the disposition with the same recovery period as the asset disposed of. The Commissioner of Internal Revenue consents to this change in method of accounting.

(ii) During 2015, F sells 20 items of mass assets with a 5-year recovery period each for \$50. As of January 1, 2015, the 2008 pool is the pool with the earliest placed-in-service year for mass assets with a 5-year recovery period, and this pool contains 25 items of mass assets with a total cost of \$10,000 and a total depreciation reserve of \$10,000. Thus, F allocates a cost of \$400 ( $\$10,000 \times (1/25)$ ) to each disposed of mass asset and depreciation allowed or allowable of \$400 to each disposed of mass asset. As a result, the adjusted depreciable basis of each disposed of mass asset is \$0. Thus, F recognizes a gain of \$50 for each disposed of mass asset in 2015, which is subject to section 1245.

(iii) Further, as of January 1, 2015, the unadjusted depreciable basis of the 2008 pool of mass assets with a 5-year recovery period is reduced from \$10,000 to \$2,000 ( $\$10,000$  less the unadjusted depreciable basis of \$8,000 for the 20 disposed of items ( $\$400 \times 20$ )), and the depreciation reserve of this 2008 pool is reduced from \$10,000 to

\$2,000 (\$10,000 less the depreciation allowed or allowable of \$8,000 for the 20 disposed of items as of December 31, 2014). Consequently, as of January 1, 2015, the 2008 pool of mass assets with a 5-year recovery period has 5 items with a total cost of \$2,000 and a depreciation reserve of \$2,000.

(j) Effective/applicability dates--(1) In general. This section applies to taxable years beginning on or after January 1, 2014.

(2) Early application of this section. A taxpayer may choose to apply the provisions of this section to taxable years beginning on or after January 1, 2012.

(3) Early application of regulation project REG-110732-13. A taxpayer may rely on the provisions of this section in regulation project REG-110732-13 (2013-43 IRB 404) (see §601.601(d)(2) of this chapter) for taxable years beginning on or after January 1, 2012. However, a taxpayer may not rely on the provisions of this section in regulation project REG-110732-13 for taxable years beginning on or after January 1, 2014.

(4) Optional application of TD 9564. A taxpayer may choose to apply §1.168(i)-8T as contained in 26 CFR part 1 edition revised as of April 1, 2014, to taxable years beginning on or after January 1, 2012. However, a taxpayer may not apply §1.168(i)-8T as contained in 26 CFR part 1 edition revised as of April 1, 2014, to taxable years beginning on or after January 1, 2014.

(5) Change in method of accounting. A change to comply with this section for depreciable assets placed in service in a taxable year ending on or after December 30, 2003, is a change in method of accounting to which the provisions of section 446(e) and the regulations under section 446(e) apply. A taxpayer also may treat a change to comply with this section for depreciable assets placed in service in a taxable year ending before December 30, 2003, as a change in method of accounting to which the

provisions of section 446(e) and the regulations under section 446(e) apply. This paragraph (j)(5) does not apply to a change to comply with paragraph (d)(2) of this section, except as provided in paragraph (d)(2)(iii) or (iv)(B) of this section or otherwise provided by other guidance published in the Internal Revenue Bulletin (see §601.601(d)(2) of this chapter).

### **§1.168(i)-8T [Removed]**

Par. 9. Section 1.168(i)-8T is removed.

### **§1.263(a)-3 [Amended]**

Par. 10. Section 1.263(a)-3 is amended by:

a. In paragraphs (g)(2)(i), (g)(2)(ii) Example 2, and (g)(2)(ii) Example 4, removing the language “Prop. Reg. §1.168(i)-8(d) (September 19, 2013)” and adding the language “§1.168(i)-8(d)” in its place.

b. In paragraph (g)(2)(i), removing the language “§1.168(i)-1T(e)(3) nor Prop. Reg. §1.168(i)-1(e)(3) (September 19, 2013)” and adding the language “§1.168(i)-1(e)(3)” in its place, and removing the language “Prop. Reg. §1.168(i)-1(e)(2)(ix) (September 19, 2013)” and adding the language “§1.168(i)-1(e)(1)(ii)” in its place.

c. In paragraphs (g)(2)(ii) and (g)(2)(ii) Example 1, removing the language “Prop. Reg. §1.168(i)-1(e) (September 19, 2013), or Prop. Reg. §1.168(i)-8 (September 19, 2013)” and adding the language “§1.168(i)-1(e) or §1.168(i)-8” in its place.

d. In paragraph (k)(7) Example 30, removing the language “Prop. Reg. §1.168(i)-8” and adding the language “§1.168(i)-8” in its place, and removing the language “Prop. Reg. §1.168(i)-8(c)(4)(ii)(A) (September 19, 2013)” and adding the language “§1.168(i)-8(c)(4)(ii)(A)” in its place.

e. In paragraph (k)(7) Example 30 and Example 31, removing the language “Prop. Reg. §1.168(i)-8(d)(2) (September 19, 2013),” and adding the language “§1.168(i)-8(d)(2)” in its place.

f. In paragraph (k)(7) Example 31, removing the language “Prop. Reg. §1.68(i)-8(c)(4)(ii)(D) (September 19, 2013)” and adding the language “§1.168(i)-8(c)(4)(ii)(D)” in its place.

Par. 11. Section 1.1016-3 is amended by revising the fourth sentence in paragraph (a)(1)(ii) to read as follows:

§1.1016-3 Exhaustion, wear and tear, obsolescence, amortization, and depletion for periods since February 13, 1913.

(a) \* \* \*

(1) \* \* \*

(ii) \* \* \* For rules governing losses on retirement or disposition of depreciable property, including rules for determining basis, see §1.167(a)-8, 1.168(i)-1(e), or 1.168(i)-8, as applicable. \* \* \*

\* \* \* \* \*

John Dalrymple,  
Deputy Commissioner for Services and Enforcement.

Approved: July 11, 2014.

Mark J. Mazur,  
Assistant Secretary of the Treasury (Tax Policy).

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