

## § 1.168(i)-1T

## 26 CFR Ch. I (4-1-13 Edition)

property.) The taxpayer's record-keeping practices should be consistently applied to the general asset accounts. If Form 4562 is revised or renumbered, any reference in this section to that form shall be treated as a reference to the revised or renumbered form.

(m) [Reserved] For further guidance, see § 1.168(i)-1T(m).

[T.D. 8566, 59 FR 51371, Oct. 11, 1994; 59 FR 64849, Dec. 16, 1994, as amended by T.D. 9115, 69 FR 9534, Mar. 1, 2004; T.D. 9132, 69 FR 33842, June 17, 2004; T.D. 9314, 72 FR 9249, Mar. 1, 2007; T.D. 9564, 76 FR 81086, Dec. 27, 2011; 77 FR 75016, Dec. 19, 2012]

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

(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 (1) 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) *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, 179A, or 190). Expensed cost does not include any additional first year depreciation deduction.

(5) *Mass assets* is a mass or group of individual items of depreciable assets—

(i) That are not necessarily homogeneous;

(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.

(6) *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.

(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 FSC (as defined in former section 922), DISC (as defined in section 992(a)), or possessions 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 (1) 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) through (n), 1400L(b), or 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 ac-

count 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)(iii) 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)(3)(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 2012, 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 income tax return for 2012, J makes an election under section 179 to expense \$500,000 of the equipment's cost and makes an election under paragraph (1) of this section to include the equipment in a general asset account. As a result, the unadjusted depreciable basis of the equipment is \$50,000. In accordance with paragraph (c)(1) of this section, J must include only \$50,000 of the equipment's cost in the general asset account.

*Example 2.* The facts are the same as in *Example 1*, except that J also places in service 99 other items of equipment in 2012. On its Federal income tax return for 2012, J 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 (1) of this section to include the

100 items of equipment in a general asset account. All of the 100 items of equipment placed in service in 2012 are 5-year property under section 168(e), are not listed property, and are not eligible for any additional first year depreciation deduction. J depreciates its 5-year property placed in service in 2012 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, J 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 J 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, J establishes 100 general asset accounts and includes one item of equipment in each general asset account.

*Example 4.* K, a calendar-year corporation, is a wholesale distributor. In 2012, K places in service the following properties for use in its wholesale distribution business: computers, automobiles, and forklifts. On its federal income tax return for 2012, K 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 (1) 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). K depreciates its 5-year property placed in service in 2012 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, K 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, K 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, K establishes three general asset accounts: One for the computers, one for the automobiles, and one for the forklifts.

*Example 5.* L, a fiscal-year corporation with a taxable year ending June 30, purchases and places in service ten items of new equipment in October 2011, and purchases and places in service five other items of new equipment in February 2012. On its federal income tax return for the taxable year ending June 30, 2012, 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 (1) 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 not property described in section 168(k)(2)(B) or (C). All of the ten items of equipment placed in service in October 2011 are eligible for the 100-percent additional first year depreciation deduction provided by section 168(k)(5). All of the five items of equipment placed in service in February 2012 are eligible for the 50-percent additional first year depreciation deduction provided by section 168(k)(1). L depreciates its 7-year property placed in service for the taxable year ending June 30, 2012, 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, L cannot include all of them in one general asset account because they are eligible for different percentages of the additional first year depreciation deduction. In accordance with paragraph (c)(2) of this section, L establishes two general asset accounts: one for the ten items of equipment eligible for the 100-percent additional first year depreciation deduction, and one for the five items of equipment eligible for the 50-percent 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 paragraphs (e)(3)(iii) (disposition of an asset in a qualifying disposition), (e)(3)(iv) (transactions subject to section 168(i)(7)), (e)(3)(v) (transactions subject to section 1031 or 1033), (e)(3)(vi) (technical termination of a partnership), (e)(3)(vii) (anti-abuse rule), (g) (assets subject to recapture), (h)(1) (conversion to personal use), or (h)(2) (business or income-producing use percentage changes) of this section.

(e) *Disposition of an asset from a general asset account—(1) Scope.* 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. A disposition also includes the retirement of a structural component (as defined in §1.48-1(e)(2)) of a building (as defined in §1.48-1(e)(1)).

(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, the asset 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. Similarly, where an asset is disposed of by transfer to a supplies, scrap, or similar account, the basis of the asset 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) to the extent the sum of the unadjusted depreciable basis of the general asset account and any expensed cost (as defined in paragraph (b)(4) 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. The recognition and character of any excess amount realized are determined under other applicable provisions of the Internal Revenue Code (other than sections 1245 and 1250 or provisions of the Internal Revenue Code that treat gain on a disposition as subject to section 1245 or 1250).

(iii) *Effect of disposition on a general asset account.* 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.

(iv) *Coordination with nonrecognition provisions.* For purposes of determining the basis of an asset acquired in a transaction, other than a transaction

described in paragraphs (e)(3)(iv) (pertaining to transactions subject to section 168(i)(7)), (e)(3)(v) (pertaining to transactions subject to section 1031 or 1033), and (e)(3)(vi) (pertaining to technical terminations of partnerships) of this section, to which a nonrecognition section of the Internal Revenue 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 of an asset in a general asset account (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 § 1.162-3T(d) to treat the cost of any material and supply 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 § 1.162-3T(d)(3) for the procedures for revoking 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 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 before or upon the termination of the lease.

(viii) *Determination of asset disposed of—(A) In general.* 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. Except as provided in paragraph (e)(2)(viii)(B) of this section, the asset cannot be larger than the unit of property as determined under § 1.263(a)-3T(e)(2), (e)(3), and (e)(5) or as otherwise determined in published guidance in the FEDERAL REGISTER or in the Internal Revenue Bulletin (see, for example, Rev. Proc. 2011-38, 2011-18 IRB 743, for units of property for wireless network assets (see § 601.601(d)(2)(ii)(b) of this chapter)).

(B) *Exceptions.* 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 (not 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 (5) of this section.

(2) If a building has two or more condominium or cooperative units, each condominium or cooperative unit (not including its structural components) is the asset except as provided in § 1.1250-1(a)(2)(ii) or in paragraph (e)(2)(viii)(B)(5) of this section.

(3) Each structural component (including all components thereof) of a building, condominium unit, or cooperative unit is the asset.

(4) 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)(ii)(b) 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 it is not larger than the unit of property as determined under § 1.263(a)-3T(e)(3) or (e)(5) or as otherwise determined in published guidance

in the FEDERAL REGISTER or in the Internal Revenue Bulletin (see § 601.601(d)(2)(ii)(b) of this chapter), or provided paragraph (e)(2)(viii)(B)(5) 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 (assuming these assets are not larger than the unit of property as determined under § 1.263(a)-3T(e)(3) or (e)(5) or as otherwise determined in published guidance in the FEDERAL REGISTER or in the Internal Revenue Bulletin (see § 601.601(d)(2)(ii)(b) of this chapter)).

(5) 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 provided it is not larger than the unit of property as determined under § 1.263(a)-3T(e)(3) or (e)(5) or as otherwise determined in published guidance in the FEDERAL REGISTER or in the Internal Revenue Bulletin (see § 601.601(d)(2)(ii)(b) of this chapter).

(6) If an asset is not described 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)(ii)(b) of this chapter) or in one of the categories under section 168(e)(3), a taxpayer also may use any reasonable, consistent method to treat each of the asset's components as the 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 this building and, after consulting with a contractor, decides to replace the entire roof. The retirement of the roof, which is a structural component of the building, is a disposition under paragraph (e)(1) of this section. However, this roof has an unadjusted depreciable basis of zero pursuant to paragraph (e)(2)(i) of this section. Accordingly, A does not recognize any loss upon the retirement of the roof. Instead, the unadjusted depreciable basis of the general asset account for the office building is not affected by the retirement of the roof and, as a result, A continues to depreciate the \$10 million cost of this general asset account.

*Example 2.* B, a calendar-year commercial airline company, maintains one general

asset account for five aircrafts that cost a total of \$500 million. B replaces the existing engines on one of the aircrafts with new engines and treats each engine of an aircraft as a major component of the aircraft. Assume each aircraft is a unit of property as determined under § 1.263(a)-3T(e)(3). However, for disposition purposes of general asset accounts, B consistently treats each major component of an aircraft as the asset. Thus, the retirement of these replaced engines is a disposition under paragraph (e)(1) of this section. However, the engines have an unadjusted depreciable basis of zero pursuant to paragraph (e)(2)(i) of this section. Accordingly, B does not recognize any loss upon the retirement of the engines. Instead, the unadjusted depreciable basis of the general asset account for the five aircrafts is not affected by the retirement of the engines and, as a result, B continues to depreciate the \$500 million cost of this general asset account.

*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 2012. 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, 2013, the depreciation reserve of the account is \$2,000 [ $\$10,000 \times 20$  percent].

(ii) On February 8, 2013, 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 2013 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 2013 is \$3,200 ( $\$10,000 \times 32$  percent).

*Example 4.* (i) The facts are the same as in *Example 3*. In addition, on June 4, 2014, 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 2014 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 Internal Revenue 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 2014 is \$1,920 (\$10,000 × 19.2 percent).

(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 income tax return (including extensions) for the taxable year in which the disposition occurs. 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 can demonstrate good cause for the revocation. 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 paragraph (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.

(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, or 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 gen-

eral 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). The recognition and character of the gain or loss are determined under other applicable provisions of the Internal Revenue Code, except that the amount of gain subject to section 1245 (or section 1250) is limited to the excess of the depreciation allowed or allowable for the general asset account, including any expensed cost (or 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 2012. 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 2013, 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, 2014, 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 2014, 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 2012. 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 2014, 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 2014, 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 of an asset (described in paragraph (e)(3)(iii)(B) of this section), 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)-8T 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. The recognition and character of the gain, loss, or other deduction are determined under other applicable provisions of the Internal Revenue 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 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, or the last asset, remaining in a general asset account and that is not described in paragraphs (e)(3)(iv) (pertaining to transactions subject to section 168(i)(7)), (v) (pertaining to transactions subject to section 1031 or 1033), (vi) (pertaining to technical terminations of partnerships), or (vii) (anti-abuse rule) of 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)-7T(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) *Example.* The following example illustrates the application of this paragraph (e)(3)(iii):

*Example.* (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 2012. 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 January 1, 2014, the depreciation reserve for the account is \$93,600.

(ii) On May 27, 2014, 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. Because this transaction is a qualifying disposition under paragraph (e)(3)(iii)(B) of this section, Z elects to apply paragraph (e)(3)(iii) of this section.

(iii) For Z'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 three machines at the Ohio plant is \$23,400. Thus, as of January 1, 2014, 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 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, 2013). Consequently, the depreciation allowance for the account in 2014 is \$25,920 (\$135,000 × 19.2 percent).

(iv) For Z's 2014 return, gain or loss for each of the three machines at the Ohio plant is determined as follows. The depreciation allowed or allowable in 2014 for each machine is \$1,440 [(\$15,000 × 19.2 percent)/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 2014). As a result, the loss recognized in 2014 for each machine is \$760 (\$5,000 - \$5,760), which is subject to section 1231.

(iv) *Transactions subject to section 168(i)(7)—(A) In general.* If a taxpayer transfers one or more assets 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 (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 (1) of this section for the portion of the transferee's basis in the asset that does not exceed the transferor's adjusted depreciable basis of the general asset account or the asset, as applicable (as determined under paragraph (e)(3)(iv)(B)(2) or (e)(3)(iv)(C)(2) of this section, as applicable).

(B) *All assets remaining in general asset account are transferred.* If a taxpayer transfers all the assets, or 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, or 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, or 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 or the last asset, and the greater of the depreciation allowed or allowable for all the assets or 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, or the last asset, were included (as deter-

mined 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)-7T or may make an election under paragraph (1) 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 paragraph (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)-7T 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, or 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—

(I) 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—

(I) 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 paragraph (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 paragraph (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 in order 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 in order 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 paragraphs (e)(2) (general disposition rules), (e)(3)(ii) (disposition of all assets remaining in a general asset account), (e)(3)(iii) (disposition of an asset in a qualifying disposition), (e)(3)(v) (transactions subject to section 1031 or 1033), or (e)(3)(vii) (anti-abuse rule) of this section applies.

(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

**§ 1.168(i)-1T**

**26 CFR Ch. I (4-1-13 Edition)**

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, or the last asset, in the general asset account, or if all the assets, or 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:

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

(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 Internal Revenue 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:

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

(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(d)(2), 50(c)(2), 168(l)(7), 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 paragraph (e)(3)(iii)(C)(2) through (4) of this section.

(h) *Changes in use—(1) Conversion to personal use.* An asset in a general asset account becomes ineligible for general asset account treatment if a taxpayer uses the asset in a personal activity during a taxable year. Upon a conversion to 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 paragraph (e)(3)(iii)(C)(2) through (4) of this section.

(2) *Business or income-producing use percentage changes.* If, after the placed-in-service year, a taxpayer uses an asset in a general asset account both in a trade or business (or for the production of income) and in a personal activity, general asset account treatment for the asset terminates as of the first day of the taxable year in which the business (or income-producing) use percentage decreases. 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 paragraph (e)(3)(iii)(C)(2) through (4) of this section.

(3) *Change in use results in a different recovery period 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)(3)(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 of 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 paragraphs (e)(3)(iii) (disposition of an asset in a qualifying disposition), (e)(3)(iv)(B) (transactions subject to section 168(i)(7)), (e)(3)(v)(B) (transactions subject to section 1031 or

1033), (e)(3)(vii) (anti-abuse rule), (g) (assets subject to recapture), (h)(1) (conversion to personal use), or (h)(2) (business or income-producing use percentage changes) of this section.

(2) *Identifying which asset is disposed of or converted.* 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—

(i) 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;

(ii) 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;

(iii) 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;

(iv) 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

(v) 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 December 23, 2011. For this purpose, a last-in, first-out method of accounting is not a designated method. Under the last-in, first-out method of accounting, the taxpayer identifies 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 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.

(3) *Basis of disposed of or converted asset.* After identifying which asset in a general asset account is disposed of or converted, the taxpayer may use any reasonable method that is consistently applied to all its general asset accounts for purposes of determining the unadjusted depreciable basis of a 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 (1), 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, 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 (1) 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)).

(2) [Reserved] For further guidance, see §1.168(i)-1(1)(2).

(3) [Reserved] For further guidance, see §1.168(i)-1(1)(3).

(m) *Effective/applicability date—(1) In general.* This section applies to taxable years beginning on or after January 1, 2014. 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) *Optional early application.* A taxpayer may choose to apply this section to taxable years beginning on or after January 1, 2012.

(3) *Change in method of accounting.* A change to comply with this section for depreciable assets placed in service in a

## § 1.168(i)-2

## 26 CFR Ch. I (4-1-13 Edition)

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)(3) does not apply to a change to comply with paragraph (e)(3)(ii), (e)(3)(iii) or paragraph (l) of this section.

(4) The applicability of this section expires on December 23, 2014.

[T.D. 9564, 76 FR 81086, Dec. 27, 2011; 77 FR 18687, Mar. 28, 2012, as amended at 77 FR 74585, Dec. 17, 2012]

### § 1.168(i)-2 Lease term.

(a) *In general.* For purposes of section 168, a lease term is determined under all the facts and circumstances. Paragraph (b) of this section and § 1.168(j)-1T, Q&A 17, describe certain circumstances that will result in a period of time not included in the stated duration of an original lease (additional period) nevertheless being included in the lease term. These rules do not prevent the inclusion of an additional period in the lease term in other circumstances.

(b) *Lessee retains financial obligation—*  
(1) *In general.* An additional period of time during which a lessee may not continue to be the lessee will nevertheless be included in the lease term if the lessee (or a related person)—

(i) Has agreed that one or both of them will or could be obligated to make a payment of rent or a payment in the nature of rent with respect to such period; or

(ii) Has assumed or retained any risk of loss with respect to the property for such period (including, for example, by holding a note secured by the property).

(2) *Payments in the nature of rent.* For purposes of paragraph (b)(1)(i) of this section, a payment in the nature of rent includes a payment intended to substitute for rent or to fund or supplement the rental payments of another. For example, a payment in the nature of rent includes a payment of any kind

(whether denominated as supplemental rent, as liquidated damages, or otherwise) that is required to be made in the event that—

(i) The leased property is not leased for the additional period;

(ii) The leased property is leased for the additional period under terms that do not satisfy specified terms and conditions;

(iii) There is a failure to make a payment of rent with respect to such additional period; or

(iv) Circumstances similar to those described in paragraph (b)(2) (i), (ii), or (iii) of this section occur.

(3) *De minimis rule.* For the purposes of this paragraph (b), obligations to make de minimis payments will be disregarded.

(c) *Multiple leases or subleases.* If property is subject to more than one lease (including any sublease) entered into as part of a single transaction (or a series of related transactions), the lease term includes all periods described in one or more of such leases. For example, if one taxable corporation leases property to another taxable corporation for a 20-year term and, as part of the same transaction, the lessee subleases the property to a tax-exempt entity for a 10-year term, then the lease term of the property for purposes of section 168 is 20 years. During the period of tax-exempt use, the property must be depreciated under the alternative depreciation system using the straight line method over the greater of its class life or 25 years (125 percent of the 20-year lease term).

(d) *Related person.* For purposes of paragraph (b) of this section, a person is related to the lessee if such person is described in section 168(h)(4).

(e) *Changes in status.* Section 168(i)(5) (changes in status) applies if an additional period is included in a lease term under this section and the leased property ceases to be tax-exempt use property for such additional period.

(f) *Example.* The following example illustrates the principles of this section. The example does not address common law doctrines or other authorities that may apply to cause an additional period to be included in the lease term or