



Tax Reduction Letter

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Reg. Section 1.168(i)-8T(b)

Dispositions of MACRS property (temporary).

(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, 179A, 179B, 179C, 179D, or 1400I(a)(1), or any similar provision, or to amortize all or some of the property's cost under section 1400I(a)(2) or any similar provision. Except as provided in § 1.168(i)-1T(e)(iii), 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)-1T(e).

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

(1) Disposition occurs when ownership of the asset is transferred or when the asset is permanently withdrawn from use either in the taxpayer's trade or business or in the production of income.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 (as defined in § 1.48-1(e)(2)) of a building (as defined in § 1.48-1(e)(1)). A disposition also occurs when an asset is transferred to a supplies, scrap, or similar account.

(2) 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.

(3) 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 § 1.162-3T(d) to treat the cost of any material and supply 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 § 1.162-3T(d)(3) for the procedures for revoking 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 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 before or upon the termination of the lease.

(4) Determination of asset disposed of --(i) In general. For purposes of applying this section, the facts and circumstances of each disposition are considered in determining what is the appropriate asset disposed of. Except as provided in paragraph (c)(4)(ii) of this section, the asset for disposition purposes 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)).

(ii) Exceptions. For purposes of applying this section:

(A) Each building (not 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 (E) of this section.

(B) 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 (c)(4)(ii)(E) of this section.

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

(D) 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 (c)(4)(ii)(E) 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)).

(E) 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).

(E) 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.

(d) Gain or loss on dispositions. Except as provided by section 280B and § 1.280B-1, the following rules apply when assets within the scope of this section are 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 (d)(1) of this section applies to the asset (instead of this paragraph (d)(2)). For a loss from physical abandonment to qualify for recognition under this paragraph (d)(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).

(e) 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 or are components. If the taxpayer accounts for the asset disposed of in a multiple asset account or pool, or the asset disposed of is a component of a larger 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 asset disposed of, the taxpayer may use any reasonable method that is consistently applied to the taxpayer's multiple asset accounts or pools or to the taxpayer's larger assets for purposes of determining the unadjusted depreciable basis of assets disposed of. To determine the adjusted depreciable basis of an asset disposed of in a multiple asset account, 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. To determine the adjusted depreciable basis of an asset disposed of that is a component of a larger asset, the depreciation allowed or allowable for the asset disposed of is computed by using the depreciation method, recovery period, and convention applicable to the larger asset of which the asset disposed of is a component and by including the portion of the additional first year depreciation deduction claimed for the larger asset that is attributable to the asset disposed of.

(f) Identification of asset disposed of --(1) In general. Except as provided in paragraph (f)(2) 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 may 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 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 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 treats the asset disposed of as being from that multiple asset account or pool.

(g) 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, the single asset account terminates at the time of the asset's disposition (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)-7T(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 (e)(2) 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) Disposed of component of a larger asset. This paragraph (g)(3) applies only to a taxpayer that uses a reasonable, consistent method to treat each of the asset's components as the asset in accordance with paragraph (c)(4)(E) of this section. If the taxpayer disposes of a component of a larger asset and the unadjusted depreciable basis of the disposed component is included in the unadjusted depreciable basis of the larger asset, then--

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

(ii) The unadjusted depreciable basis of the larger asset must be reduced by the unadjusted depreciable basis of the disposed of component as of the first day of the taxable year in which the disposition occurs. See paragraph (e)(2) of this section for determining the unadjusted depreciable basis of the disposed of component;

(iii) The depreciation reserve of the larger asset must be reduced by the depreciation allowed or allowable for the disposed of component 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 larger asset in which the disposed of component was included and by including the portion of the additional first year depreciation deduction claimed for the larger asset that is attributable to the disposed of component; and

(iv) In determining the adjusted depreciable basis of the disposed of component 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 larger asset in which the disposed of component was included and by including the portion of the additional first year depreciation deduction claimed for the larger asset that is attributable to the disposed of component.

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

Example 1.

A owns an office building with four elevators. A decides to replace one of the elevators. The retirement of the replaced elevator, which is a structural component of the building, is a disposition. As a result, depreciation for the retired elevator ceases at the time of its retirement (taking into account the applicable convention). A recognizes a loss upon this retirement.

Example 2.

B, a calendar-year commercial airline company, owns several aircrafts that are used in the commercial carrying of passengers. 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 tax

disposition purposes, B consistently treats each major component of an aircraft as the asset. Thus, the retirement of the replaced engines is a disposition. As a result, depreciation for the retired engines ceases at the time of their retirement (taking into account the applicable convention). B recognizes a loss upon this retirement.

Example 3.

The facts are the same as in Example 2, except B treats each aircraft as the asset for tax disposition purposes. Assume each aircraft is a unit of property as determined under § 1.263(a)-3T(e)(3). Thus, the replacement of the engines on one of the aircrafts is not a disposition. As a result, depreciation continues for the cost of the aircraft (including the cost of the replaced engines) and B does not recognize a loss upon this replacement.

Example 4.

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 and treats each engine of a truck as a major component of the truck. Assume each truck is a unit of property as determined under § 1.263(a)-3T(e)(3). Because the trucks are described in asset class 00.241 of *Rev. Proc. 87-56*, C must treat each truck as the asset for tax disposition purposes. Thus, the replacement of the engine on the truck is not a disposition. As a result, depreciation continues for the cost of the truck (including the cost of the replaced engine) and C does not recognize a loss upon this replacement.

Example 5.

(i) On July 1, 2009, D, a calendar-year taxpayer, purchased and placed in service a multi-story office building that costs \$ 20,000,000. The cost of each structural component of the building was not separately stated. D accounts for the building in its records as a single asset with a cost of \$ 20,000,000. D 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, 2012, the depreciation reserve for the building is \$ 1,261,000.

(ii) On June 30, 2012, D replaces one of the building's elevators. Because D cannot identify the cost of the structural components of the office building from its records, D uses a reasonable method that is consistently applied to all of the structural components of the office building to determine the cost of the elevator. Using this reasonable method, D allocates \$ 150,000 of the \$ 20,000,000 purchase price for the building to 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, 2011, is \$ 9,457.50.

(iii) For D's 2012 Federal income tax return, loss for the retired elevator is determined as follows. The depreciation allowed or allowable for 2012 for the retired elevator is \$ 1,923 ((unadjusted depreciable basis of \$ 150,000 x depreciation rate of 2.564 percent for 2012) x 6/12). Thus, the adjusted depreciable basis of the retired elevator is \$ 138,619.50 (the adjusted depreciable basis of \$ 140,542.50 removed from the building cost less the depreciation allowed or allowable of \$ 1,923 for 2012). As a result, D recognizes a loss of \$ 138,619.50 for the retired elevator in 2012, which is subject to section 1231.

(iv) For D's 2012 Federal income tax return, the depreciation allowance for the building is computed as follows. As of January 1, 2012, 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 \$ 1,251,542.50 (\$ 1,261,000 less the depreciation allowed or allowable of \$ 9,457.50 for the retired elevator as of December 31, 2011). Consequently, the depreciation allowance for the building for 2012 is \$ 508,954 (\$ 19,850,000 x depreciation rate of 2.564 percent for 2012).

Example 6.

(i) Since 2003, E, 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 E 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). E identifies any dispositions of these mass assets by specific identification.

(ii) During 2012, E sells 10 items of mass assets with a 5-year recovery period each for \$ 100. Under the specific identification method, E identifies these mass assets as being from the pool established by E in 2010 for mass assets with a 5-year recovery period. Assume E 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. E elected not to deduct the additional first year depreciation provided by section 168(k) for 5-year property placed in service during 2010. As of January 1, 2012, this pool contains 100 similar items of mass assets with a total cost of \$ 25,000 and a total depreciation reserve of \$ 13,000. Thus, E allocates a cost of \$ 250 (\$ 25,000 x (1/100)) to each disposed of mass asset and depreciation allowed or allowable of \$ 130 (\$ 13,000 x (1/100)) to each disposed of mass asset. The depreciation allowed or allowable in 2012 for each disposed of mass asset is \$ 24 [(\$ 250 x 19.2 percent)/2]. As a result, the adjusted depreciable basis of each disposed of mass asset under section 1011 is \$ 96 (\$ 250-\$ 130-\$ 24). Thus, E recognizes a gain of \$ 4 for each disposed of mass asset in 2012, which is subject to section 1245.

(iii) Further, as of January 1, 2012, the unadjusted depreciable basis of the 2010 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 2010 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, 2011). Consequently, as of January 1, 2012, the 2010 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 2012 is \$ 4,320 (\$ 22,500 x 19.2 percent).

Example 7.

(i) Same facts as in Example 6. Because of changes in E's recordkeeping in 2013, it is impracticable for E 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, E 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, 2013, 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 2013, E sells 20 items of mass assets with a 5-year recovery period each for \$ 50. As of January 1, 2013, the 2006 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, E allocates a cost of \$ 400 (\$ 10,000 x (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, E recognizes a gain of \$ 50 for each disposed of mass asset in 2013, which is subject to section 1245.

(iii) Further, as of January 1, 2013, the unadjusted depreciable basis of the 2006 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 x 20)), and the depreciation reserve of this 2006 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, 2012). Consequently, as of January 1, 2013, the 2006 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.

(i) Effective/applicability date. (1) This section applies to taxable years beginning on or after January 1, 2012.

(2) 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.

(3) Expiration Date. The applicability of this section expires on December 23, 2014.