

## Reg. Section 1.168(i)-8(i), Example 1

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



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

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

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

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

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

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

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

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

Example (8).

(i) The facts are the same as in Example 7. Ten years after replacing 60% of the roof, D replaces 55% of the roof of the building. In accordance with paragraph (c)(4)(ii)(A) and (D) of this section, for disposition purposes, the retail building, including its structural components, except the replacement 60% of the roof, is an asset and the replacement 60% of the roof is a separate asset. Assume D must capitalize the costs incurred for replacing 55% of the roof pursuant to § 1.263(a)-3(k)(1)(vi). D makes the partial disposition election provided under paragraph (d)(2) of this section for the 55% of the replaced roof. Thus, the retirement of 55% of the roof is a disposition.

(ii) However, D cannot determine from its records whether the replaced 55% is part of the 60% of the roof replaced ten years ago or whether the replaced 55% includes part or

all of the remaining 40% of the original roof. Pursuant to paragraph (g)(3) of this section, D identifies which asset it disposed of by using the first-in, first-out method of accounting. As a result, D disposed of the remaining 40% of the original roof and 25% of the 60% of the roof replaced ten years ago.

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

#### Example (9).

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

(ii) On June 30, 2014, E replaces one of the two elevators in the office building. E did not dispose of any other structural components of this building in 2014 and prior years. E makes the partial disposition election provided under paragraph (d)(2) of this section for this elevator. Although the office building, including its structural components, is the asset for disposition purposes, the result of E making the partial disposition election for the elevator is that the retirement of the replaced elevator is a disposition. Assume the replacement elevator is a restoration under § 1.263(a)-3(k), and not a betterment under § 1.263(a)-3(j) or an adaptation to a new or different use under § 1.263(a)-3(l). Because E cannot identify the cost of the elevator from its records and the replacement elevator is a restoration under § 1.263(a)-3(k), E determines the cost of the disposed elevator by discounting the cost of the replacement elevator to its placed-in-service year cost using the Producer Price Index for Final Demand. Using this reasonable method, E determines the cost of the retired elevator by discounting the cost of the replacement elevator to its cost in 2011 (the placed-in-service year) using the Producer Price Index for Final Demand, resulting in \$150,000 of the \$20,000,000 purchase price for the building to be the cost of the retired elevator. Using the optional depreciation table that corresponds with the general depreciation system, the straight-line method, a 39-year recovery period, and the mid-month convention, the depreciation allowed or allowable for the retired elevator as of December 31, 2013, is \$9,458.

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

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

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

#### Example (10).

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

(ii) During 2014, F sells 10 items of mass assets with a 5-year recovery period each for \$100. Under the specific identification method, F identifies these mass assets as being from the pool established by F in 2012 for mass assets with a 5-year recovery period. Assume F depreciates this pool using the optional depreciation table that corresponds with the general depreciation system, the 200-percent declining balance method, a 5-year recovery period, and the half-year convention. F elected not to deduct the additional first year depreciation provided by section 168(k) for 5-year property placed in service during 2012. As of January 1, 2014, this pool contains 100 similar items of mass assets with a total cost of \$25,000 and a total depreciation reserve of \$13,000. Because all the items of mass assets in the pool are similar, F allocates the cost and depreciation allowed or allowable for the pool ratably among each item in the pool. This allocation is a reasonable method because all the items of mass assets in the pool are similar. Using this reasonable method, F allocates a cost of \$250 ( $\$25,000 \times (1/100)$ ) to each disposed of mass asset and depreciation allowed or allowable of \$130 ( $\$13,000 \times (1/100)$ ) to each disposed of mass asset. The depreciation allowed or allowable in 2014 for each disposed of mass asset is \$24 ( $(\$250 \times 19.2\%)/2$ ). As a result, the adjusted depreciable basis of each disposed of mass asset under section 1011 is \$96 ( $\$250 - \$130 - \$24$ ). Thus, F recognizes a gain of \$4 for each disposed of mass asset in 2014, which is subject to section 1245.

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

Example (11).

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

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

(iii) Further, as of January 1, 2015, the unadjusted depreciable basis of the 2008 pool of mass assets with a 5-year recovery period is reduced from \$10,000 to \$2,000 ( $\$10,000$  less the unadjusted depreciable basis of \$8,000 for the 20 disposed of items ( $\$400 \times 20$ )), and the depreciation reserve of this 2008 pool is reduced from \$10,000 to \$2,000 ( $\$10,000$  less the depreciation allowed or allowable of \$8,000 for the 20 disposed of items as of December 31, 2014). Consequently, as of January 1, 2015, the 2008 pool of mass assets with a 5-year recovery period has 5 items with a total cost of \$2,000 and a depreciation reserve of \$2,000.

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