



## Tax Reduction Letter

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### T.D. 9132

June 17, 2004

**DATE:** June 17, 2004

**ACTION:** Final and temporary regulations.

**SUMMARY:** This document contains final and temporary regulations relating to the depreciation of property subject to section 168 of the Internal Revenue Code (MACRS property). Specifically, these regulations provide guidance on how to depreciate MACRS property for which the use changes in the hands of the same taxpayer. The regulations reflect changes to the law made by the Tax Reform Act of 1986.

**DATES:** *Effective Date:* These regulations are effective June 17, 2004.

*Applicability Date:* For dates of applicability, see §§ 1.168(i)-1(1)(2) and 1.168(i)-4(g).

**FOR FURTHER INFORMATION CONTACT:** Sara Logan or Kathleen Reed, (202) 622-3110 (not a toll-free number).

### SUPPLEMENTARY INFORMATION:

#### Background

This document contains amendments to 26 CFR part 1. On July 21, 2003, the IRS and Treasury Department published a notice of proposed rulemaking in the **Federal Register** (REG-138499-02; 68 *FR* 43047), relating to a change in the use of MACRS property in the hands of the same taxpayer (change in the use) under section 168(i)(5) of the Internal Revenue Code (Code) and relating to a change in the use of assets in a general asset account under section 168(i)(4). On March 1, 2004, §§ 1.168(a)-1 and 1.168(b)-1 that were contained in this notice of proposed rulemaking were withdrawn (REG-138499-02; 69 *FR* 9560). No public hearing was requested or held. Written or electronic comments responding to the notice of proposed rulemaking were received. After consideration of all the comments, the proposed regulations are adopted as amended by this Treasury decision. The revisions are discussed below.

#### Explanation of Provisions

##### *Scope*

The final regulations provide the rules for determining the annual depreciation allowance under section 168 for MACRS property as a result of a change in the use of such property. Changes in the use include a conversion of personal use property to a business or income-

producing use, a conversion of MACRS property to personal use, or a change in the use of MACRS property that results in a different recovery period, depreciation method, or both.

## I. Conversion to Business Use

The final regulations retain the rules contained in the proposed regulations, providing that personal use property converted to business or income-producing use is treated as being placed in service by the taxpayer on the date of the conversion. Thus, the property is depreciated by using the applicable depreciation method, recovery period, and convention prescribed under section 168 for the property beginning in the taxable year the change in the use occurs (year of change). No comments were received suggesting changes to these rules. The final regulations, however, clarify that these rules do not apply when another section of the Code (or regulations under that section) prescribes the depreciation treatment for a change to business use. For example, if listed property (as defined in section 280F(d)(4)) is predominantly used by a taxpayer in a qualified business use in a taxable year, then in a subsequent taxable year is exclusively used by the taxpayer for personal purposes, and then in a later taxable year is predominantly used by the taxpayer in a qualified business use, section 280F(b)(2)(A) requires that the property be depreciated under the alternative depreciation system of section 168(g) in the later taxable year and subsequent taxable years.

## II. Conversion to Personal Use

The final regulations retain the rule contained in the proposed regulations providing that a conversion of MACRS property from business or income-producing use to personal use is treated as a disposition of the property. Depreciation for the year of change is computed by taking into account the applicable convention. No gain, loss, or depreciation recapture is recognized upon the conversion. A commentator questioned whether recapture of excess depreciation under section 280F(b)(2) occurs upon a conversion of listed property from business use to only personal use. Upon this conversion, the listed property is not predominantly used in a qualified business use for that taxable year for purposes of section 280F(b) and, consequently, section 280F(b)(2) requires any excess depreciation (as defined in section 280F(b)(2)(B)) to be included in gross income for the taxable year in which the listed property is converted to personal use. Accordingly, the IRS and Treasury Department have included a cross-reference to section 280F(b)(2) in the final regulations.

## III. MACRS Property-Use Changes After Placed-In-Service Year

The final regulations provide rules for MACRS property if a change in the use of the property occurs after the property's placed-in-service year but the property continues to be MACRS property in the hands of the taxpayer.

*A. Determination of a change in the use.* The final regulations remain unchanged from the proposed regulations. Consequently, a change in the use of MACRS property generally occurs when the primary use of the MACRS property in the taxable year is different from its primary use in the immediately preceding taxable year. However, in determining whether a taxpayer begins or ceases to use MACRS property predominantly outside the United States, the predominant use, instead of the primary use, of the MACRS property governs. A commentator questioned how this predominant use test is applied to rolling stock (for example, locomotives, freight and passenger train cars) that is not described under section 168(g)(4)(B) and that is used within and without the United States. This question concerns how to trace the movement of this

rolling stock to determine its physical location, which the IRS and Treasury Department believe is beyond the scope of these regulations.

B. *Change in the use of MACRS property resulting in a different recovery period and/or depreciation method.* The final regulations retain the rules contained in the proposed regulations for determining the applicable depreciation method, recovery period, and convention used to determine the depreciation allowances for the MACRS property for the year of change and subsequent taxable years. Consequently, if a change in the use of MACRS property results in a shorter recovery period and/or a more accelerated depreciation method (for example, MACRS property ceases to be used predominantly outside the United States), the adjusted depreciable basis of the MACRS property as of the beginning of the year of change is depreciated over the shorter recovery period and/or by the more accelerated depreciation method beginning with the year of change as though the MACRS property is placed in service by the taxpayer in the year of change. If a change in the use of MACRS property results in a longer recovery period and/or a slower depreciation method (for example, MACRS property begins to be used predominantly outside the United States), the adjusted depreciable basis of the MACRS property as of the beginning of the year of change is depreciated over the longer recovery period and/or by the slower depreciation method beginning with the year of change as though the taxpayer originally placed the MACRS property in service with the longer recovery period and/or slower depreciation method.

A commentator suggested that the depreciation allowances for all changes in the use of MACRS property resulting in a different recovery period and/or depreciation method be determined beginning with the year of change by treating the new depreciation method and/or recovery period as though they applied from the date the MACRS property was originally placed in service by the taxpayer. The commentator, in effect, is requesting that the rule contained in the proposed regulations for a change in the use of MACRS property that results in a longer recovery period and/or slower depreciation method also apply to a change in the use of MACRS property that results in a shorter recovery period and/or a more accelerated depreciation method. The IRS and Treasury Department continue to believe that the rules contained in the proposed regulations are reasonable because the rules determine the depreciation allowance for any taxable year based on the primary use of the MACRS property by the taxpayer during that year. Further, for a change in the use of MACRS property that results in a shorter recovery period and/or a more accelerated depreciation method, the taxpayer either may determine the depreciation allowances as though the MACRS property is placed-in-service by the taxpayer in the year of change or may elect to disregard the change in the use and determine the depreciation allowances as though the change in the use had not occurred. As a result, the final regulations do not require a recovery period that is longer than the recovery period applicable for the MACRS property in the taxable year immediately preceding the year of change. Accordingly, the commentator's suggestion was not accepted.

Another commentator requested that *Example 4* in § 1.168(i)-5(d)(6) be clarified by stating which optional depreciation tables the transaction coefficient factors are drawn from. The IRS and Treasury Department have adopted this suggestion.

#### IV. Change in the Use During the Placed-in-Service Year

The final regulations retain the rules contained in the proposed regulations if a change in the use of MACRS property occurs during the taxable year the property is placed in service and the property continues to be MACRS property in the hands of the taxpayer. Accordingly, if the use of MACRS property changes during its placed-in-service year, the depreciation allowance

generally is determined by the primary use of the property during that taxable year. However, in determining whether MACRS property is used within or outside the United States during the placed-in-service year, the predominant use, instead of the primary use, of the MACRS property governs. Further, in determining whether MACRS property is tax-exempt use property or imported property covered by an Executive order during the placed-in-service year, the use of the property at the end of the placed-in-service year governs. Moreover, MACRS property is tax-exempt bond financed property during the placed-in-service year if a tax-exempt bond for the MACRS property is issued during the placed-in-service year.

## V. General Asset Accounts

Finally, the regulations amend the final regulations under section 168(i)(4) (TD 8566, *59 FR 51369 (1994)*) and the temporary regulations under section 168(i)(4) (TD 9115, *69 FR 9529 (2004)*) for property accounted for in a general asset account for which the use of the property changes, resulting in a different recovery period and/or depreciation method. These amendments are the same rules contained in the proposed regulations.

### *Effective Dates*

These regulations are applicable for any change in the use of MACRS property in a taxable year ending on or after June 17, 2004. For any change in the use of MACRS property after December 31, 1986, in a taxable year ending before June 17, 2004, the IRS will allow any reasonable method of depreciating the property under section 168 in the year of change and the subsequent taxable years that is consistently applied to the MACRS property for which the use changes in the hands of the same taxpayer. However, a taxpayer may choose, on a property-by-property basis, to apply the final regulations to a change in the use of MACRS property after December 31, 1986, in a taxable year ending before June 17, 2004. In this case and consistent with Chief Counsel Notice 2004-007, Change in Litigating Position-Application of Section 446(e) to Changes in Computing Depreciation (CC-2004-007, January 28, 2004, at the IRS Internet site at [www.irs.gov/foia](http://www.irs.gov/foia)), a change to the method of accounting for depreciation provided in the final regulations due to a change in the use of MACRS property in a taxable year ending on or after December 30, 2003, is a change in method of accounting and a change to the method of accounting for depreciation provided in the final regulations due to a change in the use of MACRS property after December 31, 1986, in a taxable year ending before December 30, 2003, may be treated by the taxpayer as a change in method of accounting.

### **Special Analyses**

It has been determined that this Treasury decision is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It also has been determined that section 553(b) of the Administrative Procedure Act (*5 U.S.C. chapter 5*) does not apply to these regulations and, because these regulations do not impose on small entities a collection of information requirement, the Regulatory Flexibility Act (*5 U.S.C. chapter 6*) does not apply to these regulations. Therefore, a Regulatory Flexibility Analysis is not required. Pursuant to section 7805(f) of the Code, the notice of proposed rulemaking was submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

### **Drafting Information**

The principal author of these regulations is Sara Logan, Office of Associate Chief Counsel (Passthroughs and Special Industries). However, other personnel from the IRS and Treasury Department participated in their development.

## **List of Subjects in 26 CFR Part 1**

Income taxes, Reporting and recordkeeping requirements.

## **Adoption of Amendments to the Regulations**

Accordingly, 26 CFR part 1 is amended as follows:

### **PART 1--INCOME TAXES**

**Paragraph 1.** The authority citation for part 1 is amended by adding an entry in numerical order to read as follows:

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

Section 1.168(i)-4 also issued under 26 U.S.C. 168(i)(5). \* \* \*

**Par. 2.** Section 1.168(i)-0 is amended by revising the entry for § 1.168(i)-1(h)(2) and adding entries for § 1.168(i)-1(h)(2)(i) through (h)(2)(iii) to read as follows:

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

\* \* \* \* \*

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

\* \* \* \* \*

(h) \* \* \*

(2) Change in use results in a different recovery period and/or depreciation method.

(i) No effect on general asset account election.

(ii) Asset is removed from the general asset account.

(iii) New general asset account is established.

\* \* \* \* \*

**Par. 3.** Section 1.168(i)-1 is amended by:

1. Revising paragraph (b)(1).

2. Amending paragraph (c)(2)(ii) by:

a. Removing the language "and" from the end of paragraph (c)(2)(ii)(C).

b. Removing the period "." from the end of paragraph (c)(2)(ii)(D) and adding "; and" in its place.

c. Revising paragraph (c)(2)(ii)(E).

3. Removing the language "the change in use occurs and" from the last sentence of paragraph (h)(1) and adding "the change in use occurs (the year of change) and" in its place.

4. Revising paragraph (h)(2).

5. Removing the language "(h)(1)" from paragraph (k)(1) and adding "(h)" in its place.

6. Revising paragraph (l).

The revisions read as follows:

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

\* \* \* \* \*

(b) \* \* \*

(1) *Unadjusted depreciable basis* is the basis of an asset for purposes of section 1011 without regard to any adjustments described in section 1016(a)(2) and (3). This basis reflects the reduction in basis for the percentage of the taxpayer's use of property for the taxable year other than in the taxpayer's trade or business (or for the production of income), for any portion of the basis the taxpayer properly elects to treat as an expense under section 179, and for any adjustments to basis provided by other provisions of the Internal Revenue Code and the regulations under the Internal Revenue Code (other than section 1016(a)(2) and (3)) (for example, a reduction in basis by the amount of the disabled access credit pursuant to section 44(d)(7)). For property subject to a lease, see section 167(c)(2).

\* \* \* \* \*

(c) \* \* \*

(2) \* \* \*

(ii) \* \* \*

(E) Assets subject to paragraph (h)(2)(iii)(A) of this section (change in use results in a shorter recovery period and/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.

\* \* \* \* \*

(h) \* \* \*

(2) *Change in use results in a different recovery period and/or depreciation method* -(i) *No effect on general asset account election.* A change in the use described in § 1.168(i)-4(d) (change in use results in a different recovery period and/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 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 and/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 and/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 and/or a more accelerated depreciation method) and adjustments to the general asset account are made pursuant to paragraph (h)(2)(ii) of this section, the taxpayer must establish a new general asset

account for the asset in the year of change in accordance with the rules in paragraph (c) of this section, except that the adjusted depreciable basis of the asset as of the first day of the year of change is included in the general asset account. For purposes of paragraph (c)(2) of this section, the applicable depreciation method, recovery period, and convention are determined under § 1.168(i)-4(d)(3)(i).

(B) *Change in use results in a longer recovery period and/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 and/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).

\* \* \* \* \*

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

(2) *Exceptions* -(i) *In general* -(A) Paragraph (b)(1) of this section applies on or after June 17, 2004. For the applicability of § 1.168(i)-1(b)(1) before June 17, 2004, see § 1.168(i)-1(b)(1) in effect prior to June 17, 2004 (§ 1.168(i)-1(b)(1) as contained in 26 CFR part 1 edition revised as of April 1, 2004).

(B) Paragraphs (c)(2)(ii)(E) and (h)(2) of this section apply to any change in the use of depreciable assets pursuant to § 1.168(i)-4(d) in a taxable year ending on or after June 17, 2004. For any change in the use of depreciable assets as described in § 1.168(i)-4(d) after December 31, 1986, in a taxable year ending before June 17, 2004, the Internal Revenue Service will allow any reasonable method that is consistently applied to the taxpayer's general asset accounts or the taxpayer may choose, on an asset-by-asset basis, to apply paragraphs (c)(2)(ii)(E) and (h)(2) of this section.

(ii) *Change in method of accounting* -(A) *In general.* If a taxpayer adopted a method of accounting for general asset account treatment due to a change in the use of depreciable assets pursuant to § 1.168(i)-4(d) in a taxable year ending on or after December 30, 2003, and the method adopted is not in accordance with the method of accounting provided in paragraphs (c)(2)(ii)(E) and (h)(2) of this section, a change to the method of accounting provided in paragraphs (c)(2)(ii)(E) and (h)(2) of this section is a change in method of accounting to which the provisions of section 446(e) and the regulations under section 446(e) apply. However, if a taxpayer adopted a method of accounting for general asset account treatment due to a change in the use of depreciable assets pursuant to § 1.168(i)-4(d) after December 31, 1986, in a taxable year ending before December 30, 2003, and the method adopted is not in accordance with the method of accounting provided in paragraphs (c)(2)(ii)(E) and (h)(2) of this section, the taxpayer may treat the change to the method of accounting provided in paragraphs (c)(2)(ii)(E) and (h)(2) of this section as a change in method of accounting to which the provisions of section 446(e) and the regulations under section 446(e) apply.

(B) *Automatic consent to change method of accounting.* A taxpayer changing its method of accounting in accordance with this paragraph (1)(2)(ii) must follow the applicable administrative

procedures issued under § 1.446-1(e)(3)(ii) for obtaining the Commissioner's automatic consent to a change in method of accounting (for further guidance, for example, see *Rev. Proc. 2002-9 (2002-1 C.B. 327)*, as modified by *Rev. Proc. 2004-11 (2004-3 I.R.B. 311)* (see § 601.601(d)(2)(ii)(b) of this chapter)). Because this change does not change the adjusted depreciable basis of the asset, the method change is made on a cut-off basis and, therefore, no adjustment under section 481(a) is required or allowed. For purposes of Form 3115, *Application for Change in Accounting Method*, the designated number for the automatic accounting method change authorized by this paragraph (l)(2)(ii) is "87." If Form 3115 is revised or renumbered, any reference in this section to that form is treated as a reference to the revised or renumbered form.

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

**Par. 4.** Section 1.168(i)-1T is amended by:

1. Revising paragraphs (c)(2)(ii)(E) and (l)(2).
2. Removing the language "(h)(1) (conversion to personal use)" from paragraphs (d)(2) and (i) and adding "(h) (changes in use)" in its place.
3. Removing the language "(h)(1)" from paragraph (j) and adding "(h)" in its place.

The revisions read as follows:

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

\* \* \* \* \*

(c) \* \* \*

(2) \* \* \*

(ii) \* \* \*

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

\* \* \* \* \*

(l) \* \* \*

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

\* \* \* \* \*

**Par. 5.** Section 1.168(i)-4 is added to read as follows: § 1.168(i)-4 Changes in use.

(a) *Scope.* This section provides the rules for determining the depreciation allowance for MACRS property (as defined in § 1.168(b)-1T(a)(2)) for which the use changes in the hands of the same taxpayer (change in the use). The allowance for depreciation under this section constitutes the amount of depreciation allowable under section 167(a) for the year of change and any subsequent taxable year. For purposes of this section, the year of change is the taxable year in which a change in the use occurs.

(b) *Conversion to business or income-producing use* -(1) *Depreciation deduction allowable.* This paragraph (b) applies to property that is converted from personal use to use in a taxpayer's trade or business, or for the production of income, during a taxable year. This conversion includes property that was previously used by the taxpayer for personal purposes, including real property (other than land) that is acquired before 1987 and converted from personal use to business or income-producing use after 1986, and depreciable property that was previously used by a tax-exempt entity before the entity changed to a taxable entity. Except as otherwise



provided by the Internal Revenue Code or regulations under the Internal Revenue Code, upon a conversion to business or income-producing use, the depreciation allowance for the year of change and any subsequent taxable year is determined as though the property is placed in service by the taxpayer on the date on which the conversion occurs. Thus, except as otherwise provided by the Internal Revenue Code or regulations under the Internal Revenue Code, the taxpayer must use any applicable depreciation method, recovery period, and convention prescribed under section 168 for the property in the year of change, consistent with any election made under section 168 by the taxpayer for that year (see, for example, section 168(b)(5)). See §§ 1.168(k)-1T(f)(6)(iii) and 1.1400L(b)-1T(f)(6) for the additional first year depreciation deduction rules applicable to a conversion to business or income-producing use. The depreciable basis of the property for the year of change is the lesser of its fair market value or its adjusted depreciable basis (as defined in § 1.168(b)-1T(a)(4)), as applicable, at the time of the conversion to business or income-producing use.

(2) *Example.* The application of this paragraph (b) is illustrated by the following example:

*Example.* A, a calendar-year taxpayer, purchases a house in 1985 that she occupies as her principal residence. In February 2004, A ceases to occupy the house and converts it to residential rental property. At the time of the conversion to residential rental property, the house's fair market value (excluding land) is \$ 130,000 and adjusted depreciable basis attributable to the house (excluding land) is \$ 150,000. Pursuant to this paragraph (b), A is considered to have placed in service residential rental property in February 2004 with a depreciable basis of \$ 130,000. A depreciates the residential rental property under the general depreciation system by using the straight-line method, a 27.5-year recovery period, and the mid-month convention. Pursuant to §§ 1.168(k)-1T(f)(6)(iii)(B) or 1.1400L(b)-1T(f)(6), this property is not eligible for the additional first year depreciation deduction provided by section 168(k) or section 1400L(b). Thus, the depreciation allowance for the house for 2004 is \$ 4,137, after taking into account the mid-month convention ( $(\$ 130,000 \text{ adjusted depreciable basis multiplied by the applicable depreciation rate of } 3.636\% (1/27.5)) \text{ multiplied by the mid-month convention fraction of } 10.5/12$ ). The amount of depreciation computed under section 168, however, may be limited under other provisions of the Internal Revenue Code, such as, section 280A.

(c) *Conversion to personal use.* The conversion of MACRS property from business or income-producing use to personal use during a taxable year is treated as a disposition of the property in that taxable year. The depreciation allowance for MACRS property for the year of change in which the property is treated as being disposed of is determined by first multiplying the adjusted depreciable basis of the property as of the first day of the year of change by the applicable depreciation rate for that taxable year (for further guidance, for example, see section 6 of *Rev. Proc. 87-57 (1987-2 C. B. 687, 692)* (see § 601.601(d)(2)(ii)(b) of this chapter)). This amount is then multiplied by a fraction, the numerator of which is the number of months (including fractions of months) the property is deemed to be placed in service during the year of change (taking into account the applicable convention) and the denominator of which is 12. No depreciation deduction is allowable for MACRS property placed in service and disposed of in the same taxable year. See §§ 1.168(k)-1T(f)(6)(ii) and 1.1400L(b)-1T(f)(6) for the additional first year depreciation deduction rules applicable to property placed in service and converted to personal use in the same taxable year. Upon the conversion to personal use, no gain, loss, or depreciation recapture under section 1245 or section 1250 is recognized. However, the provisions of section 1245 or section 1250 apply to any disposition of the converted property by the taxpayer at a later date. For listed property (as defined in section 280F(d)(4)), see section 280F(b)(2) for the recapture of excess depreciation upon the conversion to personal use.

(d) *Change in the use results in a different recovery period and/or depreciation method* -(1) *In general.* This paragraph (d) applies to a change in the use of MACRS property during a taxable year subsequent to the placed-in-service year, if the property continues to be MACRS property owned by the same taxpayer and, as a result of the change in the use, has a different recovery period, a different depreciation method, or both. For example, this paragraph (d) applies to MACRS property that-

(i) Begins or ceases to be used predominantly outside the United States;

(ii) Results in a reclassification of the property under section 168(e) due to a change in the use of the property; or

(iii) Begins or ceases to be tax-exempt use property (as defined in section 168(h)).

(2) *Determination of change in the use* -(i) *In general.* Except as provided in paragraph (d)(2)(ii) of this section, a change in the use of MACRS property occurs when the primary use of the MACRS property in the taxable year is different from its primary use in the immediately preceding taxable year. The primary use of MACRS property may be determined in any reasonable manner that is consistently applied to the taxpayer's MACRS property.

(ii) *Alternative depreciation system property* -(A) *Property used within or outside the United States.* A change in the use of MACRS property occurs when a taxpayer begins or ceases to use MACRS property predominantly outside the United States during the taxable year. The determination of whether MACRS property is used predominantly outside the United States is made in accordance with the test in § 1.48-1(g)(1)(i) for determining predominant use.

(B) *Tax-exempt bond financed property.* A change in the use of MACRS property occurs when the property changes to tax-exempt bond financed property, as described in section 168(g)(1)(C) and (g)(5), during the taxable year. For purposes of this paragraph (d), MACRS property changes to tax-exempt bond financed property when a tax-exempt bond is first issued after the MACRS property is placed in service. MACRS property continues to be tax-exempt bond financed property in the hands of the taxpayer even if the tax-exempt bond (including any refunding issue) is no longer outstanding or is redeemed.

(C) *Other mandatory alternative depreciation system property.* A change in the use of MACRS property occurs when the property changes to, or changes from, property described in section 168(g)(1)(B) (tax-exempt use property) or (D) (imported property covered by an Executive order) during the taxable year.

(iii) *Change in the use deemed to occur on first day of the year of change.* If a change in the use of MACRS property occurs under this paragraph (d)(2), the depreciation allowance for that MACRS property for the year of change is determined as though the use of the MACRS property changed on the first day of the year of change.

(3) *Change in the use results in a shorter recovery period and/or a more accelerated depreciation method* -(i) *Treated as placed in service in the year of change* -(A) *In general.* If a change in the use results in the MACRS property changing to a shorter recovery period and/or a depreciation method that is more accelerated than the method used for the MACRS property before the change in the use, the depreciation allowances beginning in the year of change are determined as though the MACRS property is placed in service by the taxpayer in the year of change.

(B) *Computation of depreciation allowance.* The depreciation allowances for the MACRS property for any 12-month taxable year beginning with the year of change are determined by multiplying the adjusted depreciable basis of the MACRS property as of the first day of each

taxable year by the applicable depreciation rate for each taxable year. In determining the applicable depreciation rate for the year of change and subsequent taxable years, the taxpayer must use any applicable depreciation method and recovery period prescribed under section 168 for the MACRS property in the year of change, consistent with any election made under section 168 by the taxpayer for that year (see, for example, section 168(b)(5)). If there is a change in the use of MACRS property, the applicable convention that applies to the MACRS property is the same as the convention that applied before the change in the use of the MACRS property. However, the depreciation allowance for the year of change for the MACRS property is determined without applying the applicable convention, unless the MACRS property is disposed of during the year of change. See paragraph (d)(5) of this section for the rules relating to the computation of the depreciation allowance under the optional depreciation tables. If the year of change or any subsequent taxable year is less than 12 months, the depreciation allowance determined under this paragraph (d)(3)(i) must be adjusted for a short taxable year (for further guidance, for example, see *Rev. Proc. 89-15 (1989-1 C.B. 816)* (see § 601.601(d)(2)(ii)(b) of this chapter)).

(C) *Special rules.* MACRS property affected by this paragraph (d)(3)(i) is not eligible in the year of change for the election provided under section 168(f)(1), 179, or 1400L(f), or for the additional first year depreciation deduction provided in section 168(k) or 1400L(b). See §§ 1.168(k)-1T(f)(6)(iv) and 1.1400L(b)-1T(f)(6) for other additional first year depreciation deduction rules applicable to a change in the use of MACRS property subsequent to its placed-in-service year. For purposes of determining whether the mid-quarter convention applies to other MACRS property placed in service during the year of change, the unadjusted depreciable basis (as defined in § 1.168(b)-1T(a)(3)) or the adjusted depreciable basis of MACRS property affected by this paragraph (d)(3)(i) is not taken into account.

(ii) *Option to disregard the change in the use.* In lieu of applying paragraph (d)(3)(i) of this section, the taxpayer may elect to determine the depreciation allowance as though the change in the use had not occurred. The taxpayer elects this option by claiming on the taxpayer's timely filed (including extensions) Federal income tax return for the year of change the depreciation allowance for the property as though the change in the use had not occurred. See paragraph (g)(2) of this section for the manner for revoking this election.

(4) *Change in the use results in a longer recovery period and/or a slower depreciation method* - (i) *Treated as originally placed in service with longer recovery period and/or slower depreciation method.* If a change in the use results in a longer recovery period and/or a depreciation method for the MACRS property that is less accelerated than the method used for the MACRS property before the change in the use, the depreciation allowances beginning with the year of change are determined as though the MACRS property had been originally placed in service by the taxpayer with the longer recovery period and/or the slower depreciation method. MACRS property affected by this paragraph (d)(4) is not eligible in the year of change for the election provided under section 168(f)(1), 179, or 1400L(f), or for the additional first year depreciation deduction provided in section 168(k) or 1400L(b). See §§ 1.168(k)-1T(f)(6)(iv) and 1.1400L(b)-1T(f)(6) for other additional first year depreciation deduction rules applicable to a change in the use of MACRS property subsequent to its placed-in-service year.

(ii) *Computation of the depreciation allowance.* The depreciation allowances for the MACRS property for any 12-month taxable year beginning with the year of change are determined by multiplying the adjusted depreciable basis of the MACRS property as of the first day of each taxable year by the applicable depreciation rate for each taxable year. If there is a change in the use of MACRS property, the applicable convention that applies to the MACRS property is the

same as the convention that applied before the change in the use of the MACRS property. If the year of change or any subsequent taxable year is less than 12 months, the depreciation allowance determined under this paragraph (d)(4)(ii) must be adjusted for a short taxable year (for further guidance, for example, see *Rev. Proc. 89-15 (1989-1 C.B. 816)* (see § 601.601(d)(2)(ii)(b) of this chapter)). See paragraph (d)(5) of this section for the rules relating to the computation of the depreciation allowance under the optional depreciation tables. In determining the applicable depreciation rate for the year of change and any subsequent taxable year-

(A) The applicable depreciation method is the depreciation method that would apply in the year of change and any subsequent taxable year for the MACRS property had the taxpayer used the longer recovery period and/or the slower depreciation method in the placed-in-service year of the property. If the 200-or 150-percent declining balance method would have applied in the placed-in-service year but the method would have switched to the straight line method in the year of change or any prior taxable year, the applicable depreciation method beginning with the year of change is the straight line method; and

(B) The applicable recovery period is either-

(1) The longer recovery period resulting from the change in the use if the applicable depreciation method is the 200-or 150-percent declining balance method (as determined under paragraph (d)(4)(ii)(A) of this section) unless the recovery period did not change as a result of the change in the use, in which case the applicable recovery period is the same recovery period that applied before the change in the use; or

(2) The number of years remaining as of the beginning of each taxable year (taking into account the applicable convention) had the taxpayer used the longer recovery period in the placed-in-service year of the property if the applicable depreciation method is the straight line method (as determined under paragraph (d)(4)(ii)(A) of this section) unless the recovery period did not change as a result of the change in the use, in which case the applicable recovery period is the number of years remaining as of the beginning of each taxable year (taking into account the applicable convention) based on the recovery period that applied before the change in the use.

(5) *Using optional depreciation tables* -(i) *Taxpayer not bound by prior use of table.* If a taxpayer used an optional depreciation table for the MACRS property before a change in the use, the taxpayer is not bound to use the appropriate new table for that MACRS property beginning in the year of change (for further guidance, for example, see section 8 of *Rev. Proc. 87-57 (1987-2 C.B. 687, 693)* (see § 601.601(d)(2)(ii)(b) of this chapter)). If a taxpayer did not use an optional depreciation table for MACRS property before a change in the use and the change in the use results in a shorter recovery period and/or a more accelerated depreciation method (as described in paragraph (d)(3)(i) of this section), the taxpayer may use the appropriate new table for that MACRS property beginning in the year of change. If a taxpayer chooses not to use the optional depreciation table, the depreciation allowances for the MACRS property beginning in the year of change are determined under paragraph (d)(3)(i) or (4) of this section, as applicable.

(ii) *Taxpayer chooses to use optional depreciation table after a change in the use.* If a taxpayer chooses to use an optional depreciation table for the MACRS property after a change in the use, the depreciation allowances for the MACRS property for any 12-month taxable year beginning with the year of change are determined as follows:

(A) *Change in the use results in a shorter recovery period and/or a more accelerated depreciation method.* If a change in the use results in a shorter recovery period and/or a more accelerated depreciation method (as described in paragraph (d)(3)(i) of this section), the

depreciation allowances for the MACRS property for any 12-month taxable year beginning with the year of change are determined by multiplying the adjusted depreciable basis of the MACRS property as of the first day of the year of change by the annual depreciation rate for each recovery year (expressed as a decimal equivalent) specified in the appropriate optional depreciation table. The appropriate optional depreciation table for the MACRS property is based on the depreciation system, depreciation method, recovery period, and convention applicable to the MACRS property in the year of change as determined under paragraph (d)(3)(i) of this section. The depreciation allowance for the year of change for the MACRS property is determined by taking into account the applicable convention (which is already factored into the optional depreciation tables). If the year of change or any subsequent taxable year is less than 12 months, the depreciation allowance determined under this paragraph (d)(5)(ii)(A) must be adjusted for a short taxable year (for further guidance, for example, see *Rev. Proc. 89-15 (1989-1 C.B. 816)* (see § 601.601(d)(2)(ii)(b) of this chapter)).

(B) *Change in the use results in a longer recovery period and/or a slower depreciation method* - (1) *Determination of the appropriate optional depreciation table.* If a change in the use results in a longer recovery period and/or a slower depreciation method (as described in paragraph (d)(4)(i) of this section), the depreciation allowances for the MACRS property for any 12-month taxable year beginning with the year of change are determined by choosing the optional depreciation table that corresponds to the depreciation system, depreciation method, recovery period, and convention that would have applied to the MACRS property in the placed-in-service year had that property been originally placed in service by the taxpayer with the longer recovery period and/or the slower depreciation method. If there is a change in the use of MACRS property, the applicable convention that applies to the MACRS property is the same as the convention that applied before the change in the use of the MACRS property. If the year of change or any subsequent taxable year is less than 12 months, the depreciation allowance determined under this paragraph (d)(5)(ii)(B) must be adjusted for a short taxable year (for further guidance, for example, see *Rev. Proc. 89-15 (1989-1 C.B. 816)* (see § 601.601(d)(2)(ii)(b) of this chapter)).

(2) *Computation of the depreciation allowance.* The depreciation allowances for the MACRS property for any 12-month taxable year beginning with the year of change are computed by first determining the appropriate recovery year in the table identified under paragraph (d)(5)(ii)(B)(1) of this section. The appropriate recovery year for the year of change is the year that corresponds to the year of change. For example, if the recovery year for the year of change would have been Year 4 in the table that applied before the change in the use of the MACRS property, then the recovery year for the year of change is Year 4 in the table identified under paragraph (d)(5)(ii)(B)(1) of this section. Next, the annual depreciation rate (expressed as a decimal equivalent) for each recovery year is multiplied by a transaction coefficient. The transaction coefficient is the formula  $(1 / (1-x))$  where  $x$  equals the sum of the annual depreciation rates from the table identified under paragraph (d)(5)(ii)(B)(1) of this section (expressed as a decimal equivalent) for the taxable years beginning with the placed-in-service year of the MACRS property through the taxable year immediately prior to the year of change. The product of the annual depreciation rate and the transaction coefficient is multiplied by the adjusted depreciable basis of the MACRS property as of the beginning of the year of change.

(6) *Examples.* The application of this paragraph (d) is illustrated by the following examples:

*Example 1. Change in the use results in a shorter recovery period and/or a more accelerated depreciation method and optional depreciation table is not used* - (i) X, a calendar-year corporation, places in service in 1999 equipment at a cost of \$ 100,000 and uses this equipment

from 1999 through 2003 primarily in its *A* business. *X* depreciates the equipment for 1999 through 2003 under the general depreciation system as 7-year property by using the 200-percent declining balance method (which switched to the straight-line method in 2003), a 7-year recovery period, and a half-year convention. Beginning in 2004, *X* primarily uses the equipment in its *B* business. As a result, the classification of the equipment under section 168(e) changes from 7-year property to 5-year property and the recovery period of the equipment under the general depreciation system changes from 7 years to 5 years. The depreciation method does not change. On January 1, 2004, the adjusted depreciable basis of the equipment is \$ 22,311. *X* depreciates its 5-year recovery property placed in service in 2004 under the general depreciation system by using the 200-percent declining balance method and a 5-year recovery period. *X* does not use the optional depreciation tables.

(ii) Under paragraph (d)(3)(i) of this section, *X*'s allowable depreciation deduction for the equipment for 2004 and subsequent taxable years is determined as though *X* placed the equipment in service in 2004 for use primarily in its *B* business. The depreciable basis of the equipment as of January 1, 2004, is \$ 22,311 (the adjusted depreciable basis at January 1, 2004). Because *X* does not use the optional depreciation tables, the depreciation allowance for 2004 (the deemed placed-in-service year) for this equipment only is computed without taking into account the half-year convention. Pursuant to paragraph (d)(3)(i)(C) of this section, this equipment is not eligible for the additional first year depreciation deduction provided by section 168(k) or section 1400L(b). Thus, *X*'s allowable depreciation deduction for the equipment for 2004 is \$ 8,924 (\$ 22,311 adjusted depreciable basis at January 1, 2004, multiplied by the applicable depreciation rate of 40% (200/5)). *X*'s allowable depreciation deduction for the equipment for 2005 is \$ 5,355 (\$ 13,387 adjusted depreciable basis at January 1, 2005, multiplied by the applicable depreciation rate of 40% (200/5)).

(iii) Alternatively, under paragraph (d)(3)(ii) of this section, *X* may elect to disregard the change in the use and, as a result, may continue to treat the equipment as though it is used primarily in its *A* business. If the election is made, *X*'s allowable depreciation deduction for the equipment for 2004 is \$ 8,924 (\$ 22,311 adjusted depreciable basis at January 1, 2004, multiplied by the applicable depreciation rate of 40% (1/2.5 years remaining at January 1, 2004)). *X*'s allowable depreciation deduction for the equipment for 2005 is \$ 8,925 (\$ 13,387 adjusted depreciable basis at January 1, 2005, multiplied by the applicable depreciation rate of 66.67% (1/1.5 years remaining at January 1, 2005)).

*Example 2. Change in the use results in a shorter recovery period and/or a more accelerated depreciation method and optional depreciation table is used* - (i) Same facts as in *Example 1*, except that *X* used the optional depreciation tables for computing depreciation for 1999 through 2003. Pursuant to paragraph (d)(5) of this section, *X* chooses to continue to use the optional depreciation table for the equipment. *X* does not make the election provided in paragraph (d)(3)(ii) of this section to disregard the change in use.

(ii) In accordance with paragraph (d)(5)(ii)(A) of this section, *X* must first identify the appropriate optional depreciation table for the equipment. This table is table 1 in *Rev. Proc. 87-57* because the equipment will be depreciated in the year of change (2004) under the general depreciation system using the 200-percent declining balance method, a 5-year recovery period, and the half-year convention (which is the convention that applied to the equipment in 1999). Pursuant to paragraph (d)(3)(i)(C) of this section, this equipment is not eligible for the additional first year depreciation deduction provided by section 168(k) or section 1400L(b). For 2004, *X* multiplies its adjusted depreciable basis in the equipment as of January 1, 2004, of \$ 22,311, by the annual depreciation rate in table 1 for recovery year 1 for a 5-year recovery period (.20), to

determine the depreciation allowance of \$ 4,462. For 2005, X multiplies its adjusted depreciable basis in the equipment as of January 1, 2004, of \$ 22,311, by the annual depreciation rate in table 1 for recovery year 2 for a 5-year recovery period (.32), to determine the depreciation allowance of \$ 7,140.

*Example 3. Change in the use results in a longer recovery period and/or a slower depreciation method* -(i) Y, a calendar-year corporation, places in service in January 2002, equipment at a cost of \$ 100,000 and uses this equipment in 2002 and 2003 only within the United States. Y elects not to deduct the additional first year depreciation under section 168(k). Y depreciates the equipment for 2002 and 2003 under the general depreciation system by using the 200-percent declining balance method, a 5-year recovery period, and a half-year convention. Beginning in 2004, Y uses the equipment predominantly outside the United States. As a result of this change in the use, the equipment is subject to the alternative depreciation system beginning in 2004. Under the alternative depreciation system, the equipment is depreciated by using the straight line method and a 9-year recovery period. The adjusted depreciable basis of the equipment at January 1, 2004, is \$ 48,000.

(ii) Pursuant to paragraph (d)(4) of this section, Y's allowable depreciation deduction for 2004 and subsequent taxable years is determined as though the equipment had been placed in service in January 2002, as property used predominantly outside the United States. Further, pursuant to paragraph (d)(4)(i) of this section, the equipment is not eligible in 2004 for the additional first year depreciation deduction provided by section 168(k) or section 1400L(b). In determining the applicable depreciation rate for 2004, the applicable depreciation method is the straight line method and the applicable recovery period is 7.5 years, which is the number of years remaining at January 1, 2004, for property placed in service in 2002 with a 9-year recovery period (taking into account the half-year convention). Thus, the depreciation allowance for 2004 is \$ 6,398 (\$ 48,000 adjusted depreciable basis at January 1, 2004, multiplied by the applicable depreciation rate of 13.33% (1/7.5 years)). The depreciation allowance for 2005 is \$ 6,398 (\$ 41,602 adjusted depreciable basis at January 1, 2005, multiplied by the applicable depreciation rate of 15.38% (1/6.5 years remaining at January 1, 2005)).

*Example 4. Change in the use results in a longer recovery period and/or a slower depreciation method and optional depreciation table is used* -(i) Same facts as in *Example 3*, except that Y used the optional depreciation tables for computing depreciation in 2002 and 2003. Pursuant to paragraph (d)(5) of this section, Y chooses to continue to use the optional depreciation table for the equipment. Further, pursuant to paragraph (d)(4)(i) of this section, the equipment is not eligible in 2004 for the additional first year depreciation deduction provided by section 168(k) or section 1400L(b).

(ii) In accordance with paragraph (d)(5)(ii)(B) of this section, Y must first determine the appropriate optional depreciation table for the equipment pursuant to paragraph (d)(5)(ii)(B)(I) of this section. This table is table 8 in *Rev. Proc. 87-57*, which corresponds to the alternative depreciation system, the straight line method, a 9-year recovery period, and the half-year convention (because Y depreciated 5-year property in 2002 using a half-year convention). Next, Y must determine the appropriate recovery year in table 8. Because the year of change is 2004, the depreciation allowance for the equipment for 2004 is determined using recovery year 3 of table 8. For 2004, Y multiplies its adjusted depreciable basis in the equipment as of January 1, 2004, of \$ 48,000, by the product of the annual depreciation rate in table 8 for recovery year 3 for a 9-year recovery period (.1111) and the transaction coefficient of 1.200 [1/(1-(.0556 (table 8 for recovery year 1 for a 9-year recovery period) +.1111 (table 8 for recovery year 2 for a 9-year recovery period)))]], to determine the depreciation allowance of \$ 6,399. For 2005, Y multiplies

its adjusted depreciable basis in the equipment as of January 1, 2004, of \$ 48,000, by the product of the annual depreciation rate in table 8 for recovery year 4 for a 9-year recovery period (.1111) and the transaction coefficient (1.200), to determine the depreciation allowance of \$ 6,399.

(e) *Change in the use of MACRS property during the placed-in-service year-* (1) *In general.* Except as provided in paragraph (e)(2) of this section, if a change in the use of MACRS property occurs during the placed-in-service year and the property continues to be MACRS property owned by the same taxpayer, the depreciation allowance for that property for the placed-in-service year is determined by its primary use during that year. The primary use of MACRS property may be determined in any reasonable manner that is consistently applied to the taxpayer's MACRS property. For purposes of this paragraph (e), the determination of whether the mid-quarter convention applies to any MACRS property placed in service during the year of change is made in accordance with § 1.168(d)-1.

(2) *Alternative depreciation system property-* (i) *Property used within and outside the United States.* The depreciation allowance for the placed-in-service year for MACRS property that is used within and outside the United States is determined by its predominant use during that year. The determination of whether MACRS property is used predominantly outside the United States during the placed-in-service year shall be made in accordance with the test in § 1.48-1(g)(1)(i) for determining predominant use.

(ii) *Tax-exempt bond financed property.* The depreciation allowance for the placed-in-service year for MACRS property that changes to tax-exempt bond financed property, as described in section 168(g)(1)(C) and (g)(5), during that taxable year is determined under the alternative depreciation system. For purposes of this paragraph (e), MACRS property changes to tax-exempt bond financed property when a tax-exempt bond is first issued after the MACRS property is placed in service. MACRS property continues to be tax-exempt bond financed property in the hands of the taxpayer even if the tax-exempt bond (including any refunding issue) is not outstanding at, or is redeemed by, the end of the placed-in-service year.

(iii) *Other mandatory alternative depreciation system property.* The depreciation allowance for the placed-in-service year for MACRS property that changes to, or changes from, property described in section 168(g)(1)(B) (tax-exempt use property) or (D) (imported property covered by an Executive order) during that taxable year is determined under-

(A) The alternative depreciation system if the MACRS property is described in section 168(g)(1)(B) or (D) at the end of the placed-in-service year; or

(B) The general depreciation system if the MACRS property is not described in section 168(g)(1)(B) or (D) at the end of the placed-in-service year, unless other provisions of the Internal Revenue Code or regulations under the Internal Revenue Code require the depreciation allowance for that MACRS property to be determined under the alternative depreciation system (for example, section 168(g)(7)).

(3) *Examples.* The application of this paragraph (e) is illustrated by the following examples:

*Example 1.* (i) Z, a utility and calendar-year corporation, acquires and places in service on January 1, 2004, equipment at a cost of \$ 100,000. Z uses this equipment in its combustion turbine production plant for 4 months and then uses the equipment in its steam production plant for the remainder of 2004. Z's combustion turbine production plant assets are classified as 15-year property and are depreciated by Z under the general depreciation system using a 15-year recovery period and the 150-percent declining balance method of depreciation. Z's steam production plant assets are classified as 20-year property and are depreciated by Z under the general depreciation system using a 20-year recovery period and the 150-percent declining



balance method of depreciation. Z uses the optional depreciation tables. The equipment is 50-percent bonus depreciation property for purposes of section 168(k).

(ii) Pursuant to this paragraph (e), Z must determine depreciation based on the primary use of the equipment during the placed-in-service year. Z has consistently determined the primary use of all of its MACRS properties by comparing the number of full months in the taxable year during which a MACRS property is used in one manner with the number of full months in that taxable year during which that MACRS property is used in another manner. Applying this approach, Z determines the depreciation allowance for the equipment for 2004 is based on the equipment being classified as 20-year property because the equipment was used by Z in its steam production plant for 8 months in 2004. If the half-year convention applies in 2004, the appropriate optional depreciation table is table 1 in *Rev. Proc. 87-57*, which is the table for MACRS property subject to the general depreciation system, the 150-percent declining balance method, a 20-year recovery period, and the half-year convention. Thus, the depreciation allowance for the equipment for 2004 is \$ 51,875, which is the total of \$ 50,000 for the 50-percent additional first year depreciation deduction allowable (the unadjusted depreciable basis of \$ 100,000 multiplied by .50), plus \$ 1,875 for the 2004 depreciation allowance on the remaining adjusted depreciable basis of \$ 50,000 [(the unadjusted depreciable basis of \$ 100,000 less the additional first year depreciation deduction of \$ 50,000) multiplied by the annual depreciation rate of .0375 in table 1 for recovery year 1 for a 20-year recovery period].

*Example 2.* T, a calendar year corporation, places in service on January 1, 2004, several computers at a total cost of \$ 100,000. T uses these computers within the United States for 3 months in 2004 and then moves and uses the computers outside the United States for the remainder of 2004. Pursuant to § 1.48-1(g)(1)(i), the computers are considered as used predominantly outside the United States in 2004. As a result, for 2004, the computers are required to be depreciated under the alternative depreciation system of section 168(g) with a recovery period of 5 years pursuant to section 168(g)(3)(C). T uses the optional depreciation tables. If the half-year convention applies in 2004, the appropriate optional depreciation table is table 8 in *Rev. Proc. 87-57*, which is the table for MACRS property subject to the alternative depreciation system, the straight line method, a 5-year recovery period, and the half-year convention. Thus, the depreciation allowance for the computers for 2004 is \$ 10,000, which is equal to the unadjusted depreciable basis of \$ 100,000 multiplied by the annual depreciation rate of .10 in table 8 for recovery year 1 for a 5-year recovery period. Because the computers are required to be depreciated under the alternative depreciation system in their placed-in-service year, pursuant to section 168(k)(2)(C)(i) and § 1.168(k)-1T(b)(2)(ii), the computers are not eligible for the additional first year depreciation deduction provided by section 168(k).

(f) *No change in accounting method.* A change in computing the depreciation allowance in the year of change for property subject to this section is not a change in method of accounting under section 446(e). *see* § 1.446-1T(e)(2)(ii)(d)(3)(ii).

(g) *Effective dates* -(1) *In general.* This section applies to any change in the use of MACRS property in a taxable year ending on or after June 17, 2004. For any change in the use of MACRS property after December 31, 1986, in a taxable year ending before June 17, 2004, the Internal Revenue Service will allow any reasonable method of depreciating the property under section 168 in the year of change and the subsequent taxable years that is consistently applied to any property for which the use changes in the hands of the same taxpayer or the taxpayer may choose, on a property-by-property basis, to apply the provisions of this section.

(2) *Change in method of accounting* -(i) *In general.* If a taxpayer adopted a method of accounting for depreciation due to a change in the use of MACRS property in a taxable year

ending on or after December 30, 2003, and the method adopted is not in accordance with the method of accounting for depreciation provided in this section, a change to the method of accounting for depreciation provided in this section is a change in the method of accounting to which the provisions of sections 446(e) and 481 and the regulations under sections 446(e) and 481 apply. Also, a revocation of the election provided in paragraph (d)(3)(ii) of this section to disregard a change in the use is a change in method of accounting to which the provisions of sections 446(e) and 481 and the regulations under sections 446(e) and 481 apply. However, if a taxpayer adopted a method of accounting for depreciation due to a change in the use of MACRS property after December 31, 1986, in a taxable year ending before December 30, 2003, and the method adopted is not in accordance with the method of accounting for depreciation provided in this section, the taxpayer may treat the change to the method of accounting for depreciation provided in this section as a change in method of accounting to which the provisions of sections 446(e) and 481 and the regulations under sections 446(e) and 481 apply.

(ii) *Automatic consent to change method of accounting.* A taxpayer changing its method of accounting in accordance with this paragraph (g)(2) must follow the applicable administrative procedures issued under § 1.446-1(e)(3)(ii) for obtaining the Commissioner's automatic consent to a change in method of accounting (for further guidance, for example, *see Rev. Proc. 2002-9 (2002-1 C.B. 327)*, as modified by *Rev. Proc. 2004-11 (2004-3 I.R.B. 311)* (*see* § 601.601(d)(2)(ii)(b) of this chapter)). Any change in method of accounting made under this paragraph (g)(2) must be made using an adjustment under section 481(a). For purposes of Form 3115, *Application for Change in Accounting Method*, the designated number for the automatic accounting method change authorized by this paragraph (g)(2) is "88." If Form 3115 is revised or renumbered, any reference in this section to that form is treated as a reference to the revised or renumbered form.

**Mark E. Matthews,**

*Deputy Commissioner for Services and Enforcement.*

Approved: June 7, 2004.

**Gregory F. Jenner,**

*Acting Assistant Secretary of the Treasury (Tax Policy).*

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