

Action	When	In accordance with
(5) Inspect the wing spar assemblies for cracks	Initially inspect within the next 80 hours time-in-service (TIS) after August 16, 2001 (the effective date of AD 2001-13-18) or within 12 months after August 16, 2001 (the effective date of AD 2001-13-18), whichever occurs later, unless already accomplished. Inspect thereafter at intervals not to exceed 80 hours TIS.	Raytheon Aircraft Mandatory Service Bulletin No. SB 57-3329, Issued: February, 2000.
(6) Replace any cracked wing spar assembly. A crack indication in the filler strip is allowed if the direction of the crack is toward the outside edge of the filler strip. If the direction of the crack is toward the inside edge of the filler strip or any crack is found in any other area, you must replace the cracked wing spar assembly.	Prior to further flight after the required inspection where the cracked wing spar assembly is found.	The applicable maintenance manual.
(7) Submit a report to FAA that describes the damage found on the wing spar. Use the chart on pages 58 through 60 of Raytheon Aircraft Mandatory Service Bulletin No. SB 57-3329, Issued: February, 2000.	Within 10 days after the initial inspection or within 10 days after August 16, 2001 (the effective date of AD 2001-13-18), whichever occurs later, unless already accomplished.	Pages 58 through 60 of Raytheon Aircraft Mandatory Service Bulletin No. SB 57-3329, Issued: February, 2000.
(i) Submit this report even if no cracks are found. (ii) Submit this report to FAA at the address found in paragraph (g) of this AD.		

Are Any Other ADs Affected by This Action?

(e) This AD revises AD 2001-13-18, Amendment 39-12300.

What About Alternative Methods of Compliance?

(f) As of March 15, 2004 (the effective date of this AD), all alternative methods of compliance approved under AD 2001-13-18 are not approved for this AD and are no longer valid. Any alternative method of compliance must reference "AD 2001-13-18 R1" in order to be valid.

(g) You may request a different method of compliance or a different compliance time for this AD by following the procedures in 14 CFR 39.19. Unless FAA authorizes otherwise, send your request to your principal inspector. The principal inspector may add comments and will send your request to the Manager, Wichita Aircraft Certification Office (ACO), FAA. For information on any already approved alternative methods of compliance for this AD, contact Paul Nguyen, Aerospace Engineer, FAA, Wichita Aircraft Certification Office, 1801 Airport Road, Mid-Continent Airport, Wichita, Kansas 67209; telephone: (316) 946-4125; facsimile: (316) 946-4107.

Does This AD Incorporate Any Material by Reference?

(h) You must do the actions required by this AD following the instructions in Raytheon Aircraft Mandatory Service Bulletin No. SB 57-3329, Issued: February, 2000. On August 16, 2001 (66 FR 34802, July 2, 2001), the Director of the Federal Register previously approved the incorporation by reference of this service bulletin in accordance with 5 U.S.C. 552(a) and 1 CFR part 51. You may get a copy from Raytheon Aircraft Company, P.O. Box 85, Wichita, Kansas 67201-0085; telephone: (800) 625-7043 or (316) 676-4556. You may review copies at FAA, Central Region, Office of the Regional Counsel, 901 Locust, Room 506,

Kansas City, Missouri 64106; or at the Office of the Federal Register, 800 North Capitol Street, NW., suite 700, Washington, DC.

Issued in Kansas City, Missouri, on February 23, 2004.

Dorenda D. Baker,
Manager, Small Airplane Directorate, Aircraft Certification Service.

[FR Doc. 04-4372 Filed 2-27-04; 8:45 am]

BILLING CODE 4910-13-P

DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Part 1

[TD 9115]

RIN 1545-BC27

Depreciation of MACRS Property That Is Acquired in a Like-Kind Exchange or as a Result of an Involuntary Conversion

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final and temporary regulations.

SUMMARY: This document contains regulations relating to the depreciation of property subject to section 168 of the Internal Revenue Code (MACRS property). Specifically, these temporary regulations provide guidance on how to depreciate MACRS property acquired in a like-kind exchange under section 1031 or as a result of an involuntary conversion under section 1033 when both the acquired and relinquished

property are subject to MACRS in the hands of the acquiring taxpayer. These temporary regulations will affect taxpayers involved in a like-kind exchange under section 1031 or an involuntary conversion under section 1033. The text of these temporary regulations also serves as the text of the proposed regulations set forth in the notice of proposed rulemaking on this subject in the proposed rules section in this issue of the **Federal Register**.

DATES: Effective Dates: These regulations are effective March 1, 2004.

Applicability Dates: For dates of applicability, see §§ 1.168(a)-1T(b) and (c), 1.168(b)-1T(b), 1.168(d)-1T(d), 1.168(i)-1T(l), 1.168(i)-6T(k), and 1.168(k)-1T(g).

FOR FURTHER INFORMATION CONTACT: Charles J. Magee, (202) 622-3110 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background

This document contains amendments to 26 CFR part 1 under section 168 of the Internal Revenue Code (Code). Section 168 has been modified by several Acts, including section 201 of the Tax Reform Act of 1986, Public Law 99-514 (100 Stat. 2085, 2121), section 101 of the Job Creation and Worker Assistance Act of 2002, Public Law 107-147 (116 Stat. 21), and section 201 of the Jobs and Growth Tax Relief Reconciliation Act of 2003, Public Law 108-27 (117 Stat. 752). Section 168 provides the depreciation deduction for tangible property generally placed in service after December 31, 1986.

Explanation of Provisions

Background

Section 167 allows as a depreciation deduction a reasonable allowance for the exhaustion, wear, and tear of property used in a trade or business or held for the production of income. The depreciation allowable for depreciable tangible property placed in service after 1986 generally is determined under section 168 (MACRS property). Under section 1031(a)(1), no gain or loss is recognized on an exchange of property held for productive use in a trade or business or for investment if the property is exchanged solely for property of like kind that is to be held either for productive use in a trade or business or for investment. Section 1031(b) provides that if an exchange would be within the provision of section 1031(a) were it not for the fact that the property received in the exchange consists not only of property permitted to be received in such an exchange, but also of other property or money, then the gain, if any, to the recipient shall be recognized, but in an amount not in excess of the sum of such money and the fair market value of such other property. Under section 1031(c), no loss from such a transaction is recognized. Under section 1031(d), the basis of property acquired in an exchange described in section 1031 is the same as that of the property exchanged, decreased by the amount of any money received by the taxpayer and increased by the amount of gain (or decreased by the amount of loss) that was recognized on such exchange.

Section 1033(a)(1) provides that if property (as a result of its destruction in whole or in part, theft, seizure, or requisition or condemnation or threat or imminence thereof) is compulsorily or involuntarily converted into property similar or related in service or use to the property so converted, no gain is recognized. Under section 1033(b)(1), the basis of property acquired by the taxpayer in such a transaction is the basis of the converted property. Under section 1033(a)(2)(A), if property is compulsorily or involuntarily converted into money or into property not similar or related in service or use to the converted property, and, within the time frame described in section 1033(a)(2)(B), the taxpayer purchases property that is related in service or use to the converted property or purchases stock in the acquisition of control of a corporation owning such property, then the taxpayer may elect to recognize gain only to the extent that the amount realized upon such conversion exceeds the cost of such other property. Under

section 1033(b)(2), if such an election is made, the basis of the replacement property acquired by the taxpayer generally is the cost of that property decreased by any gain not recognized by reason of section 1033(a)(2).

The IRS became aware of inconsistent depreciation treatment by taxpayers of property that has a basis determined under section 1031(d) or section 1033(b) (replacement property). Certain taxpayers were depreciating the replacement property using the same depreciation method, recovery period, and convention as the exchanged or involuntarily converted property (relinquished property) while other taxpayers were depreciating the replacement property as if it were newly placed in service.

In response, the IRS and Treasury issued Notice 2000-4 (2000-1 C.B. 313), published January 18, 2000. Notice 2000-4 instructed taxpayers how to depreciate MACRS property that has a basis determined under section 1031(d) or section 1033(b) (replacement MACRS property), provided that the exchanged or involuntarily converted property was also MACRS property (relinquished MACRS property). The notice stated that replacement MACRS property placed in service after January 3, 2000, is depreciated over the remaining recovery period of, and using the same depreciation method and convention as, the relinquished MACRS property and that any excess of the basis in the replacement MACRS property over the adjusted basis in the relinquished MACRS property is treated as newly purchased MACRS property. Notice 2000-4 also stated that the IRS and Treasury intended to issue regulations to address these transactions. Public comments on the nature and scope of these temporary regulations were requested.

Scope

The temporary regulations instruct taxpayers how to determine the annual depreciation allowance under section 168 for replacement MACRS property. Generally, MACRS property, which is defined in § 1.168(b)-1T(a)(2), is tangible property of a character subject to the allowance for depreciation provided in section 167(a) that is placed in service after December 31, 1986, and subject to section 168. The temporary regulations also apply to a transaction to which section 1031(a), (b), or (c) applies (like-kind exchange) or a transaction in which gain or loss is not recognized pursuant to section 1033 (involuntary conversion) involving MACRS property that is replaced with other MACRS

property in a transaction between members of the same affiliated group.

Property acquired in a like-kind exchange or involuntary conversion to replace property whose depreciation allowance is computed under a depreciation system other than MACRS, or to replace property for which a taxpayer made a valid election under section 168(f)(1) to exclude it from the application of section 168 (MACRS), is not within the scope of the temporary regulations. Additionally, this regulation does not provide guidance for a taxpayer acquiring property in an exchange for property that the taxpayer depreciated under the Accelerated Cost Recovery System (ACRS) or for a taxpayer acquiring an automobile for another automobile for which the taxpayer used the Standard Mileage Rate method of deducting expenses. Comments are requested on the depreciation treatment of like-kind exchange or involuntary conversion transactions described above and whether the depreciation treatment of these transactions should fall within the scope of this regulation.

The depreciation treatment used by previous owners in determining depreciation allowances for the replacement MACRS property is not relevant. For example, a taxpayer exchanging MACRS property for property that was depreciated under ACRS by the person relinquishing the property may use this regulation (because the acquired property will become MACRS property in the hands of the acquiring taxpayer). In addition, elections made by previous owners in determining depreciation allowances of the replacement MACRS property have no effect on the acquiring taxpayer. For example, a taxpayer exchanging MACRS property that the taxpayer depreciates under the general depreciation system for other MACRS property that the previous owner elected to depreciate under the alternative depreciation system pursuant to section 168(g)(7) does not have to continue using the alternative depreciation system for the replacement MACRS property.

Finally, the IRS has learned that some taxpayers question whether Notice 2000-4 allows depreciation of land, if the land is acquired in a like-kind exchange or involuntary conversion for MACRS property. As explained in further detail below, neither the temporary regulations nor Notice 2000-4 allow taxpayers to depreciate land or other nondepreciable property.

General Rule

Exchanged Basis

The temporary regulations provide rules for determining the applicable recovery period, depreciation method, and convention used to determine the depreciation allowances for the replacement MACRS property with respect to so much of the taxpayer's basis (as determined under section 1031(d) and the regulations under section 1031(d) or section 1033(b) and the regulations under section 1033(b)) in the replacement MACRS property as does not exceed the taxpayer's adjusted depreciable basis in the relinquished MACRS property (exchanged basis). In general, the exchanged basis is depreciated over the remaining recovery period of, and using the depreciation method and convention of, the relinquished MACRS property (general rule).

This general rule applies if the replacement MACRS property has the same or a shorter recovery period or the same or a more accelerated depreciation method than the relinquished MACRS property. Under certain circumstances, this rule could adversely affect taxpayers engaging in like-kind exchanges or involuntary conversions. For example, under the general rule, a taxpayer must depreciate replacement MACRS property with a shorter recovery period over the longer recovery period of the relinquished MACRS property even if the taxpayer could depreciate the replacement MACRS property over a shorter recovery period by treating such property as newly acquired MACRS property. Accordingly, the temporary regulations provide an election not to apply the temporary regulations and to treat the replacement MACRS property as MACRS property placed in service by the acquiring taxpayer at the time of replacement. Taxpayers may use this election to ameliorate the possible adverse effects of applying the general rule to this type of transaction.

The general rule does not apply if the replacement MACRS property has a longer recovery period or less accelerated depreciation method than the relinquished property. If the recovery period of the replacement MACRS property is longer than that of the relinquished MACRS property, the taxpayer's exchanged basis in the relinquished MACRS property is depreciated beginning in the year of replacement over the remainder of the recovery period that would have applied to the replacement MACRS property if the replacement MACRS property had originally been placed in

service when the relinquished MACRS property was placed in service by the acquiring taxpayer. Similarly, if the depreciation method of the replacement MACRS property is less accelerated than that of the relinquished MACRS property, then the taxpayer's exchanged basis in the relinquished MACRS property is depreciated beginning in the year of replacement using the less accelerated depreciation method of the replacement MACRS property that would have applied to the replacement MACRS property if the replacement MACRS property had originally been placed in service when the relinquished MACRS property was placed in service by the acquiring taxpayer.

For taxpayers who wish to use the optional depreciation tables to determine the depreciation allowances for the replacement MACRS property instead of the formulas (for example, *see* section 6 of Rev. Proc. 87-57 (1987-2 C.B. 687, 692)), the temporary regulations provide guidance on choosing the applicable optional table as well as how to modify the calculation for computing the depreciation allowances for the replacement MACRS property.

Excess Basis

Any excess of the taxpayer's basis in the replacement MACRS property over the taxpayer's exchanged basis in the relinquished MACRS property is referred to as the excess basis. Generally, the excess basis in the replacement MACRS property is treated as property that is placed in service by the acquiring taxpayer in the taxable year in which the replacement MACRS property is placed in service by the acquiring taxpayer or, if later, the taxable year of the disposition of the relinquished MACRS property (time of replacement). The depreciation allowances for the excess basis are determined by using the applicable recovery period, depreciation method, and convention prescribed under section 168 for the replacement MACRS property at the time of replacement. In addition, the excess basis may be taken into account for purposes of computing the deduction allowed under section 179.

Special Rules

Deferred Exchanges

Because of the complex nature of certain like-kind exchange and involuntary conversion transactions, the temporary regulations provide special rules for certain circumstances. If a taxpayer disposes of the relinquished MACRS property prior to the

acquisition of the replacement MACRS property, the temporary regulations do not allow the taxpayer to take depreciation on the relinquished MACRS property during the period between the disposition of the relinquished MACRS property and the acquisition of the replacement MACRS property. This results because, in a deferred exchange under § 1.1031(k)-1, or if a taxpayer does not replace converted property until after the taxpayer no longer owns the converted property, the taxpayer has no property to depreciate during that intervening period. Accordingly, the recovery period for the replacement MACRS property is suspended during this period. The temporary regulations do not address the issue of whether an intermediary (such as an exchange accommodation titleholder) is entitled to depreciation.

Acquisition Prior to Disposition

When replacement MACRS property is acquired and placed in service by a taxpayer before the relinquished MACRS property is disposed of by the taxpayer (for example, under threat of condemnation), the regulations allow the taxpayer to depreciate the unadjusted depreciable basis of the replacement MACRS property until the time of disposition of the relinquished MACRS property by the taxpayer. The taxpayer must include in taxable income in the year of disposition of the relinquished MACRS property the excess of the depreciation allowable on the unadjusted depreciable basis of the replacement MACRS property over the depreciation that would be allowable on the excess basis of the replacement MACRS property from the date the replacement MACRS property was placed in service by the taxpayer to the time of disposition of the relinquished MACRS property. The depreciation of the depreciable excess basis of the replacement MACRS property continues to be depreciated by the taxpayer. The IRS and Treasury may consider providing additional future guidance with respect to this issue and request comments relating thereto. The IRS and Treasury also invite taxpayers to comment on whether the allowance of depreciation for the replacement MACRS property should be followed by basis reduction at the time of disposition of the relinquished MACRS property, or whether some other approach should be taken.

Transactions Involving Nondepreciable Property

Because land or other nondepreciable property acquired in a like-kind

exchange or involuntary conversion for MACRS property is not depreciable, such property is not within the scope of the temporary regulations. Further, if MACRS property or both MACRS property and land or other nondepreciable property are acquired in a like-kind exchange or involuntary conversion for land or other nondepreciable property, the basis of the replacement MACRS property is treated as property placed in service by the acquiring taxpayer in the year of replacement.

Automobiles

The IRS received many comments concerning the like-kind exchange of automobiles. In response, the temporary regulations contain detailed rules regarding the annual allowable depreciation for automobiles acquired in a like-kind exchange or involuntary conversion. The temporary regulations provide that if the replacement MACRS property consists of a passenger automobile that is subject to the depreciation limitations of section 280F(a), then the depreciation limitation that applies for the taxable year is based on the date the replacement MACRS automobile is placed in service by the acquiring taxpayer. In allocating the depreciation limitation, the depreciation allowance for the exchanged basis in the replacement MACRS automobile generally is limited to the amount that would have been allowable under section 280F(a) for the relinquished MACRS automobile had the transaction not occurred. The depreciation allowance for the excess basis is generally limited to the section 280F(a) limitation that applies for that taxable year less the amount of the depreciation allowance for the exchanged basis.

Election Not To Apply Temporary Regulations

Commentators suggested that implementing the general rule for all depreciable property was burdensome because taxpayers would have onerous computational and administrative difficulties due to the possibility of having to track different depreciation components of one asset. Responding to these comments, the temporary regulations include a provision by which taxpayers may elect not to apply these temporary regulations. If a taxpayer elects not to apply the temporary regulations, the taxpayer must treat the entire basis (*i.e.*, both the exchanged and excess basis) of the replacement MACRS property as being placed in service by the acquiring taxpayer at the time of replacement. Consistent with this treatment, the

taxpayer treats the relinquished MACRS property as disposed of at the time of the disposition of the relinquished MACRS property. The election must be made by typing or legibly printing at the top of Form 4562, *Depreciation and Amortization*, "ELECTION MADE UNDER SECTION 1.168(i)-6T(i)," or in the manner provided for on Form 4562 and its instructions.

Additional First Year Depreciation

Temporary regulations issued under §§ 1.168(k)-1T and 1.1400L(b)-1T (TD 9091, 68 FR 52986 (September 8, 2003)) provide that the exchanged basis (referred to as the "carryover basis" in such regulations) and the excess basis, if any, of the replacement MACRS property (referred to as the "acquired MACRS property" in such regulations) is eligible for the additional first year depreciation deduction provided under section 168(k) or 1400L(b) if the replacement MACRS property is qualified property under section 168(k)(2), 50-percent bonus depreciation property under section 168(k)(4), or qualified New York Liberty Zone property under section 1400L(b)(2). However, if qualified property, 50-percent bonus depreciation property, or qualified New York Liberty Zone property is placed in service by the taxpayer and then disposed of by that taxpayer in a like-kind exchange or involuntary conversion in the same taxable year, the relinquished MACRS property (referred to as the "exchanged or involuntarily converted MACRS property" in such regulations) is not eligible for the additional first year depreciation deduction under section 168(k) or 1400L(b), as applicable. However, the exchanged basis (and excess basis, if any) of the replacement MACRS property may be eligible for the additional first year depreciation deduction under section 168(k) or 1400L(b), as applicable, subject to the requirements of section 168(k) or 1400L(b), as applicable. The rules provided under §§ 1.168(k)-1T and 1.1400L(b)-1T apply even if the taxpayer elects not to apply these temporary regulations.

These temporary regulations amend the definition of time of replacement in § 1.168(k)-1T(f)(5)(ii)(F) to be consistent with the definition of that term under these temporary regulations. In addition, these temporary regulations modify the like-kind exchange or involuntary conversion examples contained in § 1.168(k)-1T(f)(5)(v) to reflect the placed in service date (taking into account the convention as determined under these temporary regulations) for the relinquished

MACRS property and the replacement MACRS property in the year of disposition and year of replacement.

Since the publication of § 1.168(k)-1T and 1.1400L(b)-1T, we have received comments regarding the application of the additional first year depreciation deduction rules in §§ 1.168(k)-1T(f)(5) and 1.1400L(b)-1T(f)(5) to qualified property, 50-percent bonus depreciation property, or qualified New York Liberty Zone property acquired in a like-kind exchange or an involuntary conversion. We will consider these comments when §§ 1.168(k)-1T and 1.1400L(b)-1T are finalized.

General Asset Accounts

Some commentators questioned how the general rule set forth in Notice 2000-4 affects the tax treatment of like-kind exchanges or involuntary conversions involving MACRS assets contained in general asset accounts as described in § 1.168(i)-1.

Section 1.168(i)-1(e)(2) treats like-kind exchanges or involuntary conversions as dispositions of the relinquished MACRS property and acquisitions of the replacement MACRS property. As a result, any amount realized on a like-kind exchange or involuntary conversion is recognized as ordinary income and the basis of the relinquished MACRS property in the general asset account continues to be depreciated. However, § 1.168(i)-1(e)(3)(iii) allows a taxpayer to elect to terminate general asset account treatment for the relinquished MACRS property, and, as a result, the tax treatment of the like-kind exchange or involuntary conversion is determined under section 1031 or section 1033, as applicable.

These temporary regulations amend the final regulations under section 168(i)(4) (TD 8566, 59 FR 51369 (1994)) to address the like-kind exchange or involuntary conversion of MACRS property contained in a general asset account. Under the temporary regulations, general asset account treatment terminates for the relinquished MACRS property as of the first day of the year of disposition. Because this rule would require taxpayers to track each property in a general asset account, the IRS and Treasury request comments on alternative methods to account for a like-kind exchange or involuntary conversion involving MACRS property contained in a general asset account when the replacement MACRS property has a longer recovery period or less accelerated depreciation method than the relinquished MACRS property or when the basis of the general asset

account would change as a result of the like-kind exchange or involuntary conversion.

Exchanges of Multiple Properties

The determination of the basis of property acquired in a like-kind exchange involving multiple properties is described in § 1.1031(j)-1 and the determination of the basis of multiple properties acquired as a result of an involuntary conversion is described in § 1.1033(b)-1. Commentators question how the rules set forth in Notice 2000-4 affects the depreciation treatment of a like-kind exchange or an involuntary conversion involving multiple properties. At this time, taxpayers may apply the principles of this temporary regulation to determine the depreciation treatment of MACRS property acquired in these transactions. The IRS and Treasury may consider providing future guidance with respect to this issue and request comments relating thereto. Specifically, comments are requested on the depreciation treatment of these transactions when the depreciation methods or recovery periods of the replacement MACRS properties differ from those of the relinquished MACRS properties.

Effect on Other Documents

The following publication is obsolete after February 27, 2004: Notice 2000-4 (2000-1 C.B. 313).

Taxpayers who have either relinquished or an acquired MACRS property in a like-kind exchange or involuntary conversion between January 3, 2000, and February 27, 2004, may rely on Notice 2000-4.

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. For the applicability of the Regulatory Flexibility Act (5 U.S.C. chapter 6), refer to the Special Analyses section of the preamble to the cross-reference notice of proposed rulemaking published in the proposed rules section in this issue of the **Federal Register**. Pursuant to section 7805(f) of the Code, these temporary regulations will be submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

Drafting Information

The principal authors of these regulations are Alan H. Cooper, Office of the Chief Counsel (Small Business/Self Employed), and Charles J. Magee, Office of the 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.

Temporary 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 continues to read in part as follows:

Authority: 26 U.S.C. 7805 * * * § 1.168(i)-1T also issued under 26 U.S.C. 168(i)(4).

■ **Par. 2.** Sections 1.168(a)-1T and 1.168(b)-1T are added to read as follows:

§ 1.168(a)-1T Modified accelerated cost recovery system (temporary).

(a) Section 168 determines the depreciation allowance for tangible property that is of a character subject to the allowance for depreciation provided in section 167(a) and that is placed in service after December 31, 1986 (or after July 31, 1986, if the taxpayer made an election under section 203(a)(1)(B) of the Tax Reform Act of 1986; 100 Stat. 2143). Except for property excluded from the application of section 168 as a result of section 168(f) or as a result of a transitional rule, the provisions of section 168 are mandatory for all eligible property. The allowance for depreciation under section 168 constitutes the amount of depreciation allowable under section 167(a). The determination of whether tangible property is property of a character subject to the allowance for depreciation is made under section 167 and the regulations under section 167.

(b) This section is applicable on and after February 27, 2004.

(c) The applicability of this section expires on or before February 27, 2007.

§ 1.168(b)-1T Definitions (temporary).

(a) **Definitions.** For purposes of section 168 and the regulations under section 168, the following definitions apply:

(1) **Depreciable property** is property that is of a character subject to the allowance for depreciation as

determined under section 167 and the regulations under section 167.

(2) **MACRS property** is tangible, depreciable property that is placed in service after December 31, 1986 (or after July 31, 1986, if the taxpayer made an election under section 203(a)(1)(B) of the Tax Reform Act of 1986; 100 Stat. 2143) and subject to section 168, except for property excluded from the application of section 168 as a result of section 168(f) or as a result of a transitional rule.

(3) **Unadjusted depreciable basis** is the basis of property 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 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).

(4) **Adjusted depreciable basis** is the unadjusted depreciable basis of the property, as defined in § 1.168(b)-1T(a)(3), less the adjustments described in section 1016(a)(2) and (3).

(b) **Effective date.** (1) This section is applicable on February 27, 2004.

(2) The applicability of this section expires on or before February 27, 2007.

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

■ 1. Revising paragraph (b)(3).

■ 2. Adding paragraph (d)(3).

The addition and revision read as follows:

§ 1.168(d)-1 Applicable conventions—half-year and mid-quarter conventions.

* * * * *

(b) * * *

(3) * * * (i) and (ii) [Reserved] For further guidance, see § 1.168(d)-1T(b)(3)(i) and (ii).

* * * * *

(d) * * *

(3) **Like-kind exchanges and involuntary conversions.** [Reserved] For further guidance, see § 1.168(d)-1T(d)(3)(i).

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

■ 1. Revising paragraphs (a) through (b)(3)(ii).

■ 2. Adding paragraph (d)(3).

The addition and revisions read as follows:

§ 1.168(d)–1T Applicable conventions—half-year and mid-quarter conventions (temporary).

(a) Through (b)(2) [Reserved]. For further guidance, see § 1.168(d)–1(a) through (b)(2).

(b)(3) *Property placed in service and disposed of in the same taxable year—*(i) Under section 168(d)(3)(B)(ii), the depreciable basis of property placed in service and disposed of in the same taxable year is not taken into account in determining whether the 40-percent test is satisfied. However, the depreciable basis of property placed in service, disposed of, subsequently reacquired, and again placed in service, by the taxpayer in the same taxable year must be taken into account in applying the 40-percent test, but the basis of the property is only taken into account on the later of the dates that the property is placed in service by the taxpayer during the taxable year. Further, see § 1.168(i)–6T(c)(4)(v)(B) and § 1.168(i)–6T(f) for rules relating to property placed in service and exchanged or involuntarily converted during the same taxable year.

(ii) The applicable convention, as determined under this section, applies to all depreciable property (except nonresidential real property, residential rental property, and any railroad grading or tunnel bore) placed in service by the taxpayer during the taxable year, excluding property placed in service and disposed of in the same taxable year. However, see § 1.168(i)–6T(c)(4)(v)(A) and § 1.168(i)–6T(f) for rules relating to MACRS property that has a basis determined under section 1031(d) or section 1033(b). No depreciation deduction is allowed for property placed in service and disposed of during the same taxable year. However, see § 1.168(k)–1T(f)(1) for rules relating to qualified property or 50-percent bonus depreciation property, and § 1.1400L(b)–1T(f)(1) for rules relating to qualified New York Liberty Zone property, that is placed in service by the taxpayer in the same taxable year in which either a partnership is terminated as a result of a technical termination under section 708(b)(1)(B) or the property is transferred in a transaction described in section 168(i)(7).

* * * * *

(d)(2) * * *

(3) *Like-kind exchanges and involuntary conversions.* (i) The last sentence in paragraph (b)(3)(i) and the second sentence in paragraph (b)(3)(ii) of this section apply to exchanges to which section 1031 applies, and involuntary conversions to which section 1033 applies, of MACRS

property for which the time of disposition and the time of replacement both occur after February 27, 2004.

(ii) The applicability of this section expires on or before February 27, 2007.

■ **Par. 5.** In § 1.168(i)–0, the entries for § 1.168(i)–1(d)(2), (e)(3)(i), (f), (f)(1), (f)(2), (f)(2)(i), (i), (j) and (l) are revised, the entry for (e)(3)(v) is removed and a new entry for (e)(3)(v) and (vi) is added.

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

* * * * *

§ 1.168(i)–1 General asset accounts.

* * * * *

(d) * * *

(2) [Reserved]. For further guidance see the entry for § 1.168(i)–1T(d)(2).

* * * * *

(e) * * *

(3) * * *

(i) [Reserved]. For further guidance see the entry for § 1.168(i)–1T(e)(3)(i).

* * * * *

(v) and (vi) [Reserved]. For further guidance see the entries for § 1.168(i)–1T(e)(3)(v) and (vi).

* * * * *

(f) through (f)(2)(i) [Reserved]. For further guidance see the entries for § 1.168(i)–1T(f) through (f)(2)(i).

* * * * *

(i) and (j). [Reserved]. For further guidance, see the entries for § 1.168(i)–1T(i) and (j).

* * * * *

(l) [Reserved]. For further guidance, see the entry for § 1.168(i)–1T(l).

■ **Par. 6.** Section 1.168(i)–0T is added to read as follows:

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

This section lists the major paragraphs contained in § 1.168(i)–1T.

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

(a) through (d)(1) [Reserved]. For further guidance, see the entries for § 1.168(i)–1(a) through (d)(1).

(2) Special rule for passenger automobiles.

(e) through (e)(3) [Reserved]. For further guidance, see the entries for § 1.168(i)–1(e) through (e)(3).

(i) In general.
(e)(3)(ii) through (e)(3)(iv) [Reserved].

For further guidance, see the entries for § 1.168(i)–1(e)(3)(ii) through (iv).

(v) Transactions subject to section 1031 or 1033.

(vi) Anti-abuse rule.

(f) Assets generating foreign source income.

(1) In general.

(2) Source of ordinary income, gain, or loss.

(i) Source determined by allocation and apportionment of depreciation allowed.

(f)(2)(ii) through (h)(2) [Reserved]. For further guidance, see the entries for § 1.168(i)–1(f)(2)(ii) through (h)(2).

(i) Identification of disposed or converted asset.

(j) Effect of adjustments on prior dispositions.

(k)(1) through (k)(3) [Reserved]. For further guidance, see the entries for § 1.168(i)–1 (k)(1) through (k)(3).

(l) Effective date.

(l)(1) through (l)(3) [Reserved]. For further guidance, see the entries for § 1.168(i)–1(l)(1) through (l)(3).

■ **Par. 7.** Section 1.168(i)–1 is amended by:

■ 1. Redesignating paragraph (e)(3)(v) as paragraph (e)(3)(vi).

■ 2. Adding paragraphs (c)(2)(ii)(E) and (e)(3)(v).

■ 3. Revising paragraphs (d)(2), (e)(3)(i), (e)(3)(iii)(B)(4), newly designated (e)(3)(vi), (f)(1), (f)(2)(i), (i), (j), and (l).

The additions and revisions read as follows:

§ 1.168(i)–1 General asset accounts.

* * * * *

(c) * * *

(2) * * * (ii) * * *

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

(d) * * *

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

(e) * * *

(3) * * *

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

* * * * *

(iii) * * *

(B) * * *

(4) [Reserved]. For further guidance, see § 1.168(i)–1T(e)(3)(iii)(B)(4).

* * * * *

(e)(3)(v) [Reserved]. For further guidance, see § 1.168(i)–1T(e)(3)(v).

(vi) *Anti-abuse rule—*[Reserved]. For further guidance, see § 1.168(i)–1T(e)(3)(vi).

(f) * * * (1) *In general.* [Reserved]. For further guidance, see § 1.168(i)–1T(f)(1).

(2) * * * (i) [Reserved]. For further guidance, see § 1.168(i)–1T(f)(2)(i).

* * * * *

(i) *Identification of disposed or converted asset.* [Reserved]. For further guidance, see § 1.168(i)–1T(i).

(j) *Effect of adjustments on prior dispositions.* [Reserved]. For further guidance, see § 1.168(i)–1T(j).

* * * * *

(l) Effective date—[Reserved]. For further guidance, see § 1.168(i)–1T(l).

■ **Par. 8.** Section 1.168(i)–1T is added to read as follows:

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

(a) through (c)(2)(ii)(D) [Reserved]. For further guidance, see § 1.168(i)–1(a) through (c)(2)(ii)(D).

(c)(2)(ii)(E) [Reserved].

(d)(1) [Reserved]. For further guidance, see § 1.168(i)–1(d)(1).

(d)(2) *Special rule for passenger automobiles.* For purposes of applying section 280F(a), the depreciation allowance for a general asset account established for passenger automobiles is limited for each taxable year to the amount prescribed in section 280F(a) multiplied by the excess of the number of automobiles originally included in the account over the number of automobiles disposed of during the taxable year or in any prior taxable year in a transaction described in paragraph (e)(3)(iii) (disposition of an asset in a qualifying disposition), (e)(3)(iv) (transactions subject to section 168(i)(7)), (e)(3)(v) (transactions subject to section 1031 or 1033), (e)(3)(vi) (anti-abuse rule), (g) (assets subject to recapture), or (h)(1) (conversion to personal use) of this section.

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

(e)(3) *Special rules*—(i) *In general.* This paragraph (e)(3) provides the rules for terminating general asset account treatment upon certain dispositions. While the rules under paragraphs (e)(3)(ii) and (iii) of this section are optional rules, the rules under paragraphs (e)(3)(iv), (v), and (vi) of this section are mandatory rules. A taxpayer applies paragraph (e)(3)(ii) or (iii) of this section by reporting the gain, loss, or other deduction on the taxpayer's timely filed Federal income tax return (including extensions) for the taxable year in which the disposition occurs. For purposes of applying paragraph (e)(3)(iii) through (vi) of this section, see paragraph (i) of this section for identifying the unadjusted depreciable basis of a disposed asset.

(e)(3)(ii) through (e)(3)(iii)(B)(3) [Reserved]. For further guidance, see § 1.168(i)–1(e)(3)(ii) through (e)(3)(iii)(B)(3).

(e)(3)(iii)(B)(4) A transaction, other than a transaction described in paragraph (e)(3)(iv) of this section (pertaining to transactions subject to section 168(i)(7)) and (e)(3)(v) of this section (pertaining to transactions subject to section 1031 or 1033), to which a nonrecognition section of the Code applies (determined without regard to this section).

(e)(3)(iii)(C) through (e)(3)(iv) [Reserved]. For further guidance, see § 1.168(i)–1(e)(iii)(C) through (e)(3)(iv).

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

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

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

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

(1) The amount of gain or loss for the asset is determined by taking into account the asset's adjusted basis at the time of disposition (as defined in § 1.168(i)–6T(b)(3)). The adjusted basis of the asset at the time of disposition

equals the unadjusted depreciable basis of the asset less the depreciation allowed or allowable for the asset, computed by using the depreciation method, recovery period, and convention applicable to the general asset account in which the asset was included. The depreciation allowance for the asset in the year of disposition is determined in the same manner as the depreciation allowance for the relinquished MACRS property (as defined in § 1.168(i)–6T(b)(2)) in the year of disposition is determined under § 1.168(i)–6T. The recognition and character of the gain or loss are determined in accordance with paragraph (e)(3)(iii)(A) of this section (notwithstanding that paragraph (e)(3)(iii) of this section is an optional rule); and

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

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

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

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

(2) An election made under this section with a principal purpose of disposing of an asset from a general

asset account in order to utilize an expiring net operating loss or credit. The fact that a taxpayer with a net operating loss carryover or a credit carryover transfers an asset to a related person or transfers an asset pursuant to an arrangement where the asset continues to be used (or is available for use) by the taxpayer pursuant to a lease (or otherwise) indicates, absent strong evidence to the contrary, that the transaction is described in this paragraph (e)(3)(vi)(B).

(f) *Assets generating foreign source income*—(1) *In general.* This paragraph (f) provides the rules for determining the source of any income, gain, or loss recognized, and the appropriate section 904(d) separate limitation category or categories for any foreign source income, gain, or loss recognized, on a disposition (within the meaning of paragraph (e)(1) of this section) of an asset in a general asset account that consists of assets generating both United States and foreign source income. These rules apply only to a disposition to which paragraph (e)(2) (general disposition rules), (e)(3)(ii) (disposition of all assets remaining in a general asset account), (e)(3)(iii) (disposition of an asset in a qualifying disposition), (e)(3)(v) (transactions subject to section 1031 or 1033), or (e)(3)(vi) (anti-abuse rule) of this section applies.

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

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

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

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

involuntary conversion), or if the asset is disposed in a transaction described in paragraph (e)(3)(vi) of this section (anti-abuse rule).

(f)(2)(ii) through (h) [Reserved]. For further guidance, see § 1.168(i)–1(f)(2)(ii) through (h).

(i) *Identification of disposed or converted asset.* A taxpayer may use any reasonable method that is consistently applied to the taxpayer's general asset accounts for purposes of determining the unadjusted depreciable basis of a disposed or converted asset in a transaction described in paragraph (e)(3)(iii) (disposition of an asset in a qualifying disposition), (e)(3)(iv) (transactions subject to section 168(i)(7)), (e)(3)(v) (transactions subject to section 1031 or 1033), (e)(3)(vi) (anti-abuse rule), (g) (assets subject to recapture), or (h)(1) (conversion to personal use) of this section.

(j) *Effect of adjustments on prior dispositions.* The adjustments to a general asset account under paragraph (e)(3)(iii), (e)(3)(iv), (e)(3)(v), (e)(3)(vi), (g), or (h)(1) of this section have no effect on the recognition and character of prior dispositions subject to paragraph (e)(2) of this section.

(k) [Reserved]. For further guidance, see § 1.168(i)–1(k).

(l) *Effective date*—(1) *In general.* Except as provided in paragraphs (l)(2) and (l)(3) of this section, this section applies to depreciable assets placed in service in taxable years ending on or after October 11, 1994. For depreciable assets placed in service after December 31, 1986, in taxable years ending before October 11, 1994, the Internal Revenue Service will allow any reasonable method that is consistently applied to the taxpayer's general asset accounts.

(2) [Reserved].

(3) *Like-kind exchanges and involuntary conversions.* (i) This section applies for an asset transferred by a taxpayer in a like-kind exchange (as defined under § 1.168–6T(b)(11)) or in an involuntary conversion (as defined under § 1.168–6T(b)(12)) for which the time of disposition (as defined in § 1.168(i)–6T(b)(3)) and the time of replacement (as defined in § 1.168(i)–6T(b)(4)) both occur after February 27, 2004. For an asset transferred by a taxpayer in a like-kind exchange or in an involuntary conversion for which the time of disposition, the time of replacement, or both occur on or before February 27, 2004, see § 1.168(i)–1 in effect prior to February 27, 2004, (§ 1.168(i)–1 as contained in 26 CFR part 1 edition revised as of April 1, 2003).

(ii) The applicability of this section expires on or before February 27, 2007.

■ **Par. 9.** Section 1.168(i)–5T is added to read as follows:

§ 1.168(i)–5T Table of contents (temporary).

This section lists the major paragraphs contained in § 1.168(i)–6T.

§ 1.168(i)–6T Like-kind exchanges and involuntary conversions (temporary).

- (a) Scope.
- (b) Definitions.
 - (1) Replacement MACRS property.
 - (2) Relinquished MACRS property.
 - (3) Time of disposition.
 - (4) Time of replacement.
 - (5) Year of disposition.
 - (6) Year of replacement.
 - (7) Exchanged basis.
 - (8) Excess basis.
 - (9) Depreciable exchanged basis.
 - (10) Depreciable excess basis.
 - (11) Like-kind exchange.
 - (12) Involuntary conversion.
- (c) Determination of depreciation allowance.
 - (1) Computation of the depreciation allowance for depreciable exchanged basis beginning in the year of replacement.
 - (i) In general.
 - (ii) Applicable recovery period, depreciation method, and convention.
 - (2) Effect of depreciation treatment of the replacement MACRS property by previous owners of the acquired property.
 - (3) Recovery period and/or depreciation method of the properties are the same, or both are not the same.
 - (i) In general.
 - (ii) Both the recovery period and the depreciation method are the same.
 - (iii) Either the recovery period or the depreciation method is the same, or both are not the same.
 - (4) Recovery period or depreciation method of the properties is not the same.
 - (i) Longer recovery period.
 - (ii) Shorter recovery period.
 - (iii) Less accelerated depreciation method.
 - (iv) More accelerated depreciation method.
 - (v) Convention.
 - (A) In general.
 - (B) Mid-quarter convention.
 - (5) Year of disposition and year of replacement.
 - (i) Relinquished MACRS property.
 - (ii) Replacement MACRS property.
 - (A) Year of replacement is 12 months.
 - (B) Year of replacement is less than 12 months.
 - (iii) Deferred transactions.
 - (A) In general.
 - (B) Allowable depreciation for a qualified intermediary.
 - (iv) Remaining recovery period.
 - (6) Examples.
 - (d) Special rules for determining depreciation allowances.
 - (1) Excess basis.
 - (i) In general.
 - (ii) Example.
 - (2) Depreciable and nondepreciable property.
 - (3) Depreciation limitations for automobiles.
 - (i) In general.

(ii) Order in which limitations on depreciation under section 280F(a) are applied.

(iii) Depreciation allowance for depreciable excess basis.

(iv) Examples.

(4) Replacement MACRS property acquired and placed in service before disposition of relinquished MACRS property.

(e) Use of optional depreciation tables.

(1) Taxpayer not bound by prior use of table.

(2) Determination of the depreciation deduction.

(i) Relinquished MACRS property.

(ii) Replacement MACRS property.

(A) Determination of the appropriate optional depreciation table.

(B) Calculating the depreciation deduction for the replacement MACRS property.

(iii) Unrecovered basis.

(3) Excess basis.

(4) Examples.

(f) Mid-quarter convention.

(1) Exchanged basis.

(2) Excess basis.

(3) Depreciable property acquired for nondepreciable property.

(g) Section 179 election.

(h) Additional first year depreciation deduction.

(i) Election not to apply this section.

(j) Time and manner of making elections.

(1) In general.

(2) Time for making election.

(3) Manner of making election.

(4) Revocation.

(k) Effective date.

(1) In general.

(2) Application to pre-effective date like-kind exchanges and involuntarily conversions.

■ **Par. 10.** Section 1.168(i)-6T is added to read as follows:

§ 1.168(i)-6T Like-kind exchanges and involuntary conversions (temporary).

(a) *Scope.* This section provides the rules for determining the depreciation allowance for MACRS property acquired in a like-kind exchange or an involuntary conversion, including a like-kind exchange or an involuntary conversion of MACRS property that is exchanged or replaced with other MACRS property in a transaction between members of the same affiliated group. The allowance for depreciation under this section constitutes the amount of depreciation allowable under section 167(a) for the year of replacement and any subsequent taxable year for the replacement MACRS property and for the year of disposition of the relinquished MACRS property. The provisions of this section apply only to MACRS property to which § 1.168(h)-1 (like-kind exchanges of tax-exempt use property) does not apply. Additionally, paragraphs (c) through (f) of this section apply only to MACRS property for which an election has not

been made under paragraph (i) of this section.

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

(1) *Replacement MACRS property* is MACRS property (as defined in § 1.168(b)-1T(a)(2)) in the hands of the acquiring taxpayer that is acquired for other MACRS property in a like-kind exchange or an involuntary conversion.

(2) *Relinquished MACRS property* is MACRS property that is transferred by the taxpayer in a like-kind exchange, or in an involuntary conversion.

(3) *Time of disposition* is when the disposition of the relinquished MACRS property takes place under the convention, as determined under § 1.168(d)-1T, that applies to the relinquished MACRS property.

(4) *Time of replacement* is the later of:

(i) When the replacement MACRS property is placed in service under the convention, as determined under this section, that applies to the replacement MACRS property; or

(ii) The time of disposition of the exchanged or involuntarily converted property.

(5) *Year of disposition* is the taxable year that includes the time of disposition.

(6) *Year of replacement* is the taxable year that includes the time of replacement.

(7) *Exchanged basis* is determined after the depreciation deductions for the year of disposition are determined under paragraph (c)(5)(i) of this section and is the lesser of—

(i) The basis in the replacement MACRS property, as determined under section 1031(d) and the regulations under section 1031(d) or section 1033(b) and the regulations under section 1033(b); or

(ii) The adjusted depreciable basis (as defined in § 1.168(b)-1T(a)(4)) of the relinquished MACRS property.

(8) *Excess basis* is any excess of the basis in the replacement MACRS property, as determined under section 1031(d) and the regulations under section 1031(d) or section 1033(b) and the regulations under section 1033(b), over the exchanged basis as determined under paragraph (b)(7) of this section.

(9) *Depreciable exchanged basis* is the exchanged basis as determined under paragraph (b)(7) of this section reduced by—

(i) The percentage of such basis attributable to 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); and

(ii) Any adjustments to basis provided by other provisions of the Internal Revenue Code and the regulations under

the Code (including section 1016(a)(2) and (3), for example, depreciation deductions in the year of replacement allowable under section 168(k) or 1400L(b)).

(10) *Depreciable excess basis* is the excess basis as determined under paragraph (b)(8) of this section reduced by—

(i) The percentage of such basis attributable to 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);

(ii) Any portion of the basis the taxpayer properly elects to treat as an expense under section 179; and

(iii) Any adjustments to basis provided by other provisions of the Internal Revenue Code and the regulations under the Code (including section 1016(a)(2) and (3), for example, depreciation deductions in the year of replacement allowable under section 168(k) or 1400L(b)).

(11) *Like-kind exchange* is an exchange of property for other property (or money) in a transaction to which section 1031(a)(1), (b), or (c) applies.

(12) *Involuntary conversion* is a transaction described in section 1033(a)(1) or (2) that resulted in the nonrecognition of any part of the gain realized as the result of the conversion.

(c) *Determination of depreciation allowance—*(1) *Computation of the depreciation allowance for depreciable exchanged basis beginning in the year of replacement—*(i) *In general.* This paragraph (c) provides rules for determining the applicable recovery period, the applicable depreciation method, and the applicable convention used to determine the depreciation allowances for the depreciable exchanged basis beginning in the year of replacement. See paragraph (c)(5) of this section for rules relating to the computation of the depreciation allowance for the year of disposition and for the year of replacement. See paragraph (d)(1) of this section for rules relating to the computation of the depreciation allowance for depreciable excess basis. See paragraph (d)(4) of this section if the replacement MACRS property is acquired before disposition of the relinquished MACRS property in a transaction to which section 1033 applies. See paragraph (e) of this section for rules relating to the computation of the depreciation allowance using the optional depreciation tables.

(ii) *Applicable recovery period, depreciation method, and convention.* The recovery period, depreciation method, and convention determined under this paragraph (c) are the only permissible methods of accounting for

MACRS property within the scope of this section unless the taxpayer makes the election under paragraph (i) of this section not to apply this section.

(2) *Effect of depreciation treatment of the replacement MACRS property by previous owners of the acquired property.* If replacement MACRS property is acquired by a taxpayer in a like-kind exchange or an involuntary conversion, the depreciation treatment of the replacement MACRS property by previous owners has no effect on the determination of depreciation allowances for the replacement MACRS property in the hands of the acquiring taxpayer. For example, a taxpayer exchanging, in a like-kind exchange, MACRS property for property that was depreciated under ACRS by the previous owner must use this section because the replacement property will become MACRS property in the hands of the acquiring taxpayer. In addition, elections made by previous owners in determining depreciation allowances for the replacement MACRS property have no effect on the acquiring taxpayer. For example, a taxpayer exchanging, in a like-kind exchange, MACRS property that the taxpayer depreciates under the general depreciation system for other MACRS property that the previous owner elected to depreciate under the alternative depreciation system (ADS) pursuant to section 168(g)(7) does not have to continue using the ADS for the replacement MACRS property.

(3) *Recovery period and/or depreciation method of the properties are the same, or both are not the same—*

(i) *In general.* For purposes of paragraphs (c)(3) and (c)(4) of this section in determining whether the recovery period and the depreciation method prescribed under section 168 for the replacement MACRS property are the same as the recovery period and the depreciation method prescribed under section 168 for the relinquished MACRS property, the recovery period and the depreciation method for the replacement MACRS property are considered to be the recovery period and the depreciation method that would have applied, taking into account any elections made by the acquiring taxpayer under section 168(b)(5) or 168(g)(7), had the replacement MACRS property been placed in service by the acquiring taxpayer at the same time as the relinquished MACRS property.

(ii) *Both the recovery period and the depreciation method are the same.* If both the recovery period and the depreciation method prescribed under section 168 for the replacement MACRS property are the same as the recovery period and the depreciation method

prescribed under section 168 for the relinquished MACRS property, the depreciation allowances for the replacement MACRS property beginning in the year of replacement are determined by using the same recovery period and depreciation method that were used for the relinquished MACRS property. Thus, the replacement MACRS property is depreciated over the remaining recovery period (taking into account the applicable convention), and by using the depreciation method, of the relinquished MACRS property. Except as provided in paragraph (c)(5) of this section, the depreciation allowances for the depreciable exchanged basis for any 12-month taxable year beginning with the year of replacement are determined by multiplying the depreciable exchanged basis by the applicable depreciation rate for each taxable year (for further guidance, for example, see section 6 of Rev. Proc. 87-57 (1987-2 C.B. 687, 692) and § 601.601(d)(2)(ii)(b) of this chapter).

(iii) *Either the recovery period or the depreciation method is the same, or both are not the same.* If either the recovery period or the depreciation method prescribed under section 168 for the replacement MACRS property is the same as the recovery period or the depreciation method prescribed under section 168 for the relinquished MACRS property, the depreciation allowances for the depreciable exchanged basis beginning in the year of replacement are determined using the recovery period or the depreciation method that is the same as the relinquished MACRS property. See paragraph (c)(4) of this section to determine the depreciation allowances when the recovery period or the depreciation method of the replacement MACRS property is not the same as that of the relinquished MACRS property.

(4) *Recovery period or depreciation method of the properties is not the same.* If the recovery period prescribed under section 168 for the replacement MACRS property (as determined under paragraph (c)(3)(i) of this section) is not the same as the recovery period prescribed under section 168 for the relinquished MACRS property, the depreciation allowances for the depreciable exchanged basis beginning in the year of replacement are determined under this paragraph (c)(4). Similarly, if the depreciation method prescribed under section 168 for the replacement MACRS property (as determined under paragraph (c)(3)(i) of this section) is not the same as the depreciation method prescribed under section 168 for the relinquished MACRS property, the depreciation method used

to determine the depreciation allowances for the depreciable exchanged basis beginning in the year of replacement is determined under this paragraph (c)(4).

(i) *Longer recovery period.* If the recovery period prescribed under section 168 for the replacement MACRS property (as determined under paragraph (c)(3)(i) of this section) is longer than that prescribed for the relinquished MACRS property, the depreciation allowances for the depreciable exchanged basis beginning in the year of replacement are determined as though the replacement MACRS property had originally been placed in service by the acquiring taxpayer in the same taxable year the relinquished MACRS property was placed in service by the acquiring taxpayer, but using the longer recovery period of the replacement MACRS property (as determined under paragraph (c)(3)(i) of this section) and the convention determined under paragraph (c)(4)(v) of this section. Thus, the depreciable exchanged basis is depreciated over the remaining recovery period (taking into account the applicable convention) of the replacement MACRS property.

(ii) *Shorter recovery period.* If the recovery period prescribed under section 168 for the replacement MACRS property (as determined under paragraph (c)(3)(i) of this section) is shorter than that of the relinquished MACRS property, the depreciation allowances for the depreciable exchanged basis beginning in the year of replacement are determined using the same recovery period as that of the relinquished MACRS property. Thus, the depreciable exchanged basis is depreciated over the remaining recovery period (taking into account the applicable convention) of the relinquished MACRS property.

(iii) *Less accelerated depreciation method—*(A) If the depreciation method prescribed under section 168 for the replacement MACRS property (as determined under paragraph (c)(3)(i) of this section) is less accelerated than that of the relinquished MACRS property at the time of disposition, the depreciation allowances for the depreciable exchanged basis beginning in the year of replacement are determined as though the replacement MACRS property had originally been placed in service by the acquiring taxpayer at the same time the relinquished MACRS property was placed in service by the acquiring taxpayer, but using the less accelerated depreciation method. Thus, the depreciable exchanged basis is

depreciated using the less accelerated depreciation method.

(B) Except as provided in paragraph (c)(5) of this section, the depreciation allowances for the depreciable exchanged basis for any 12-month taxable year beginning in the year of replacement are determined by multiplying the adjusted depreciable basis by the applicable depreciation rate for each taxable year. If, for example, the depreciation method of the replacement MACRS property in the year of replacement is the 150-percent declining balance method and the depreciation method of the relinquished MACRS property in the year of replacement is the 200-percent declining balance method, and neither method had been switched to the straight line method in the year of replacement or any prior taxable year, the applicable depreciation rate for the year of replacement and subsequent taxable years is determined by using the depreciation rate of the replacement MACRS property as if the replacement MACRS property was placed in service by the acquiring taxpayer at the same time the relinquished MACRS property was placed in service by the acquiring taxpayer, until the 150-percent declining balance method has been switched to the straight line method. If, for example, the depreciation method of the replacement MACRS property is the straight line method, the applicable depreciation rate for the year of replacement is determined by using the remaining recovery period at the beginning of the year of disposition (as determined under this paragraph (c)(4) and taking into account the applicable convention).

(iv) *More accelerated depreciation method*—(A) If the depreciation method prescribed under section 168 for the replacement MACRS property (as determined under paragraph (c)(3)(i) of this section) is more accelerated than that of the relinquished MACRS property at the time of disposition, the depreciation allowances for the replacement MACRS property beginning in the year of replacement are determined using the same depreciation method as the relinquished MACRS property.

(B) Except as provided in paragraph (c)(5) of this section, the depreciation allowances for the depreciable exchanged basis for any 12-month taxable year beginning in the year of replacement are determined by multiplying the adjusted depreciable basis by the applicable depreciation rate for each taxable year. If, for example, the depreciation method of the relinquished MACRS property in the year of

replacement is the 150-percent declining balance method and the depreciation method of the replacement MACRS property in the year of replacement is the 200-percent declining balance method, and neither method had been switched to the straight line method in the year of replacement or any prior taxable year, the applicable depreciation rate for the year of replacement and subsequent taxable years is the same depreciation rate that applied to the relinquished MACRS property in the year of replacement, until the 150-percent declining balance method has been switched to the straight line method. If, for example, the depreciation method is the straight line method, the applicable depreciation rate for the year of replacement is determined by using the remaining recovery period at the beginning of the year of disposition (as determined under this paragraph (c)(4) and taking into account the applicable convention).

(v) *Convention*—(A) *In general*. The applicable convention for the exchanged basis is determined under this paragraph (c)(4)(v). The applicable convention for the exchanged basis is deemed to be the mid-month convention for replacement MACRS property that is nonresidential real property, residential rental property, or any railroad grading or tunnel bore. Thus, if the relinquished MACRS property was depreciated using the mid-month convention, then the replacement MACRS property is deemed to have been placed in service by the acquiring taxpayer in the same month as the relinquished MACRS property and must continue to be depreciated using the mid-month convention. If nonresidential real property, residential rental property, or any railroad grading or tunnel bore is received as a result of an exchange or an involuntarily conversion of MACRS property that was depreciated using the mid-quarter convention, the replacement MACRS property is deemed to have been placed in service by the acquiring taxpayer in the month that includes the mid-point of the quarter that the relinquished MACRS property was placed in service and must be depreciated using the mid-month convention. If nonresidential real property, residential rental property, or any railroad grading or tunnel bore is received as a result of an exchange or an involuntarily conversion of MACRS property that was depreciated using the half-year convention, the replacement MACRS property is deemed to have been placed in service by the acquiring

taxpayer in the month that includes the mid-point of the placed-in-service year and must be depreciated using the mid-month convention (for example, for a calendar-year taxpayer with a full 12-month taxable year, the mid-point is the first day of the second half of the taxable year (the seventh month)). For all other replacement MACRS property, the applicable convention is the half-year convention, unless the applicable convention for the relinquished MACRS property is the mid-quarter convention, in which case the mid-quarter convention is applied to the replacement MACRS property.

(B) *Mid-quarter convention*. See paragraph (f) of this section for purposes of applying the 40-percent test of section 168(d)(3) to any replacement MACRS property.

(5) *Year of disposition and year of replacement*. No depreciation deduction is allowable for MACRS property disposed of by a taxpayer in a like-kind exchange or involuntary conversion in the same taxable year that such property was placed in service by the taxpayer. If replacement MACRS property is disposed of by a taxpayer during the same taxable year that the relinquished MACRS property is placed in service by the taxpayer, no depreciation deduction is allowable for either MACRS property. Otherwise, the depreciation allowances for the year of disposition and for the year of replacement are determined as follows:

(i) *Relinquished MACRS property*. Except as provided in paragraphs (e) and (i) of this section, the depreciation allowance in the year of disposition for the relinquished MACRS property is computed by multiplying the allowable depreciation deduction for the property for that year 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 disposition (taking into account the applicable convention of the relinquished MACRS property), and the denominator of which is 12. However, if the year of disposition is less than 12 months, the depreciation allowance determined under this paragraph (c)(5)(i) must be adjusted for a short taxable year (for further guidance, for example, see Rev. Proc. 89-15 (1989-1 C.B. 816) and § 601.601(d)(2)(ii)(b) of this chapter). In the case of termination under § 1.168(i)-1T(e)(3)(v) of general asset account treatment of an asset, or of all the assets remaining, in a general asset account, the allowable depreciation deduction in the year of disposition for the asset or assets for which general asset account treatment is terminated is determined

using the depreciation method, recovery period, and convention of the general asset account. This allowable depreciation deduction is adjusted to account for the period the asset or assets is deemed to be in service in accordance with this paragraph (c)(5)(i).

(ii) *Replacement MACRS property—*
(A) *Year of replacement is 12 months.* Except as provided in paragraphs (c)(5)(iii), (e), and (i) of this section, the depreciation allowance in the year of replacement for the depreciable exchanged basis is determined by—

(1) Calculating the applicable depreciation rate for that taxable year by taking into account the recovery period and depreciation method prescribed for the replacement MACRS property under paragraph (c)(3) or (4) of this section;

(2) Calculating the depreciable exchanged basis of the replacement MACRS property, and adding to that amount the amount determined under paragraph (c)(5)(i) of this section for the year of disposition; and

(3) Multiplying the product of the amounts determined under § 1.168(i)–6T(c)(5)(ii)(A)(1) and (A)(2) by a fraction, the numerator of which is the number of months (including fractions of months) the property is deemed to be in service during the year of replacement (in the year of replacement the replacement MACRS property is deemed to be placed in service by the acquiring taxpayer at the time of replacement under the convention determined under paragraph (c)(4)(v) of this section), and the denominator of which is 12.

(B) *Year of replacement is less than 12 months.* If the year of replacement is less than 12 months, the depreciation allowance determined under paragraph (c)(5)(ii)(A) of this section must be adjusted for a short taxable year (for further guidance, for example, see Rev. Proc. 89–15 (1989–1 C.B. 816) and § 601.601(d)(2)(ii)(b) of this chapter).

(iii) *Deferred transactions—*(A) *In general.* If the replacement MACRS property is not acquired until after the disposition of the relinquished MACRS property, depreciation is not allowable during the period between the disposition of the relinquished MACRS property and the acquisition of the replacement MACRS property. The recovery period for the replacement MACRS property is suspended during this period. For purposes of paragraph (c)(5)(ii) of this section, only the depreciable exchanged basis of the replacement MACRS property is taken into account for calculating the amount in paragraph (c)(5)(ii)(A)(2) of this section if the year of replacement is a

taxable year subsequent to the year of disposition.

(B) *Allowable depreciation for a qualified intermediary.* [Reserved].

(iv) *Remaining recovery period.* The remaining recovery period of the replacement MACRS property is determined as of the beginning of the year of disposition of the relinquished MACRS property. For purposes of determining the remaining recovery period of the replacement MACRS property, the replacement MACRS property is deemed to have been originally placed in service under the convention determined under paragraph (c)(4)(v) of this section but at the time the relinquished MACRS property was deemed to be placed in service under the convention that applied to it when it was placed in service.

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

Example 1. A1, a calendar-year taxpayer, exchanges Building M, an office building, for Building N, a warehouse in a like-kind exchange. Building M is relinquished in July 2004 and Building N is acquired and placed in service in October 2004. A1 did not make any elections under section 168 for either Building M or Building N. The unadjusted depreciable basis of Building M was \$4,680,000 when placed in service in July 1997. Since the recovery period and depreciation method prescribed under section 168 for Building N (39 years, straight line method) are the same as the recovery period and depreciation method prescribed under section 168 for Building M (39 years, straight line method), Building N is depreciated over the remaining recovery period of, and using the same depreciation method and convention as that of, Building M. Thus, Building N will be depreciated using the straight line method over a remaining recovery period of 32 years beginning in October 2004 (the remaining recovery period of 32 years and 6.5 months at the beginning of 2004, less the 6.5 months of depreciation taken prior to the disposition of the exchanged MACRS property (Building M) in 2004). For 2004, the year in which the transaction takes place, the depreciation allowance for Building M is $(\$120,000)(6.5/12)$ which equals \$65,000. The depreciation allowance for Building N for 2004 is $(\$120,000)(2.5/12)$ which equals \$25,000. For 2005 and subsequent years, Building N is depreciated over the remaining recovery period of, and using the same depreciation method and convention as that of, Building M. Thus, the depreciation allowance for Building N is the same as Building M, namely \$10,000 per month.

Example 2. B, a calendar-year taxpayer, placed in service Bridge P in January 1998. Bridge P is depreciated using the half-year convention. In January 2004, B exchanges Bridge P for Building Q, an apartment building, in a like-kind exchange. B did not make any elections under section 168 for either Bridge P or Building Q. Since the

recovery period prescribed under section 168 for Building Q (27.5 years) is longer than that of Bridge P (15 years), Building Q is depreciated as if it had originally been placed in service in July 1998 and disposed of in July 2004 using a 27.5 year recovery period. Additionally, since the depreciation method prescribed under section 168 for Building Q (straight line method) is less accelerated than that of Bridge P (150-percent declining balance method), then the depreciation allowance for Building Q is computed using the straight line method. Thus, when Building Q is acquired and placed in service in 2004, its basis is depreciated over the remaining 21.5 year recovery period using the straight line method of depreciation and the mid-month convention beginning in July 2004.

Example 3. C, a calendar-year taxpayer, placed in service Building R, a restaurant, in January 1996. In January 2004, C exchanges Building R for Tower S, a radio transmitting tower, in a like-kind exchange. C did not make any elections under section 168 for either Building R or Tower S. Since the recovery period prescribed under section 168 for Tower S (15 years) is shorter than that of Building R (39 years), Tower S is depreciated over the remaining recovery period of Building R. Additionally, since the depreciation method prescribed under section 168 for Tower S (150% declining balance method) is more accelerated than that of Building R (straight line method), then the depreciation allowance for Tower S is also computed using the same depreciation method as Building R. Thus, Tower S is depreciated over the remaining 31 year recovery period of Building R using the straight line method of depreciation and the mid-month convention. Alternatively, C may elect under paragraph (i) of this section to treat Tower S as though it is placed in service in January 2004. In such case, C uses the applicable recovery period, depreciation method, and convention prescribed under section 168 for Tower S.

Example 4. (i) In February 2001, D, a calendar-year taxpayer and manufacturer of rubber products, acquired for \$60,000 and placed in service Asset T (a special tool) and depreciated Asset T using the straight line method election under section 168(b)(5) and the mid-quarter convention over its 3-year recovery period. In June 2004, D exchanges Asset T for Asset U (not a special tool) in a like-kind exchange. D elected not to deduct the additional first year depreciation for 7-year property placed in service in 2004. Since the recovery period prescribed under section 168 for Asset U (7 years) is longer than that of Asset T (3 years), Asset U is depreciated as if it had originally been placed in service in February 2001 using a 7-year recovery period. Additionally, since the depreciation method prescribed under section 168 for Asset U (200-percent declining balance method) is more accelerated than that of Asset T (straight line method) at the time of disposition, the depreciation allowance is computed using the straight line method. Asset U is depreciated over its remaining recovery period of 3.75 years using the straight line method of depreciation and the mid-quarter convention.

(ii) The 2004 depreciation allowance for Asset T is \$938 (\$2,500 allowable depreciation deduction (\$60,000 original basis minus \$17,500 depreciation deduction for 2001 minus \$20,000 depreciation deduction for 2002 minus \$20,000 depreciation deduction for 2003) \times 4.5 months \div 12).

(iii) The depreciation rate in 2004 for Asset U is 0.2424 (1 \div 4.125 years (the length of the applicable recovery period remaining as of the beginning of 2004)). Therefore, the depreciation allowance in 2004 is \$379 (0.2424 \times \$2,500 (the sum of the \$1,562 depreciable exchanged basis of Asset U (\$2,500 basis at the beginning of 2004 for Asset T, less the \$938 depreciation allowable for Asset T for 2004) and the \$938 depreciation allowable for Asset T for 2004) \times 7.5 months \div 12).

Example 5. On January 1, 2004, E, a calendar-year taxpayer, acquired and placed in service Canopy V, a gas station canopy. The purchase price of Canopy V was \$60,000. On August 1, 2004, Canopy V was destroyed in a hurricane and was therefore no longer usable in E's business. On October 1, 2004, as part of the involuntary conversion, E acquired and placed in service Canopy W with the insurance proceeds E received due to the loss of Canopy V. E elected not to deduct the additional first year depreciation for 5-year property placed in service in 2004. E depreciates both canopies under the general depreciation system of section 168(a) by using the 200-percent declining balance method of depreciation, a 5-year recovery period, and the half-year convention. No depreciation deduction is allowable for Canopy V. The depreciation deduction allowable for Canopy W for 2004 is \$12,000 (\$60,000 \times the annual depreciation rate of .40 \times 1/2 year).

Example 6. Same facts as in *Example 5*, except that E did not make the election out of the additional first year depreciation for 5-year property placed in service in 2004. E depreciates both canopies under the general depreciation system of section 168(a) by using the 200-percent declining balance method of depreciation, a 5-year recovery period, and the half-year convention. No depreciation deduction is allowable for Canopy V. For 2004, E is allowed a 50-percent additional first year depreciation deduction of \$30,000 for Canopy W (the unadjusted depreciable basis of \$60,000 multiplied by .50), and a regular MACRS depreciation deduction of \$6,000 for Canopy W (the depreciable exchanged basis of \$30,000 multiplied by the annual depreciation rate of .40 \times 1/2 year). For 2005, E is allowed a regular MACRS depreciation deduction of \$9,600 for Canopy W (the depreciable exchanged basis of \$24,000 (\$30,000 minus regular 2003 depreciation of \$6,000) multiplied by the annual depreciation rate of .40).

(d) *Special rules for determining depreciation allowances*—(1) *Excess basis*—(i) *In general.* Any excess basis in the replacement MACRS property is treated as property that is placed in service by the acquiring taxpayer in the year of replacement. Thus, the

depreciation allowances for the depreciable excess basis are determined by using the applicable recovery period, depreciation method, and convention prescribed under section 168 for the property at the time of replacement. However, if replacement MACRS property is disposed of during the same taxable year the relinquished MACRS property is placed in service by the acquiring taxpayer, no depreciation deduction is allowable for either MACRS property. See paragraph (g) of this section regarding the application of section 179. See paragraph (h) of this section regarding the application of section 168(k) or 1400L(b).

(ii) *Example.* The application of this paragraph (d)(1) is illustrated by the following example:

Example. In 1989, G placed in service a hospital. On January 16, 2004, G exchanges this hospital plus \$2,000,000 cash for an office building in a like-kind exchange. On January 16, 2004, the hospital has an adjusted depreciable basis of \$1,500,000. After the exchange, the basis of the office building is \$3,500,000. The depreciable exchanged basis of the office building is depreciated in accordance with paragraph (c) of this section. The depreciable excess basis of \$2,000,000 is treated as being placed in service by G in 2004 and, as a result, is depreciated using the applicable depreciation method, recovery period, and convention prescribed for the office building under section 168 at the time of replacement.

(2) *Depreciable and nondepreciable property*—(i) If land or other nondepreciable property is acquired in a like-kind exchange for, or as a result of an involuntary conversion of, depreciable property, the land or other nondepreciable property is not depreciated. If both MACRS and nondepreciable property are acquired in a like-kind exchange for, or as part of an involuntary conversion of, MACRS property, the basis allocated to the nondepreciable property (as determined under section 1031(d) and the regulations under section 1031(d) or section 1033(b) and the regulations under section 1033(b)) is not depreciated and the basis allocated to the replacement MACRS property (as determined under section 1031(d) and the regulations under section 1031(d) or section 1033(b) and the regulations under section 1033(b)) is depreciated in accordance with this section.

(ii) If MACRS property is acquired, or if both MACRS and nondepreciable property are acquired, in a like-kind exchange for, or as part of an involuntary conversion of, land or other nondepreciable property, the basis in the replacement MACRS property that is attributable to the relinquished nondepreciable property is treated as

though the replacement MACRS property is placed in service by the acquiring taxpayer in the year of replacement. Thus, the depreciation allowances for the replacement MACRS property are determined by using the applicable recovery period, depreciation method, and convention prescribed under section 168 for the replacement MACRS property at the time of replacement. See paragraph (g) of this section regarding the application of section 179. See paragraph (h) of this section regarding the application of section 168(k) or 1400L(b).

(3) *Depreciation limitations for automobiles*—(i) *In general.* Depreciation allowances under section 179 and section 167 (including allowances under sections 168 and 1400L(b)) for a passenger automobile, as defined in section 280F(d)(5), are subject to the limitations of section 280F(a). The depreciation allowances for a passenger automobile that is replacement MACRS property (replacement MACRS passenger automobile) generally are limited in any taxable year to the replacement automobile section 280F limit for the taxable year. The taxpayer's basis in the replacement MACRS passenger automobile is treated as being comprised of two separate components. The first component is the exchanged basis and the second component is the excess basis, if any. The depreciation allowances for a passenger automobile that is relinquished MACRS property (relinquished MACRS passenger automobile) for the taxable year generally are limited to the relinquished automobile section 280F limit for that taxable year. For purposes of this paragraph (d)(3), the following definitions apply:

(A) *Replacement automobile section 280F limit* is the limit on depreciation deductions under section 280F(a) for the taxable year based on the time of replacement of the replacement MACRS passenger automobile (including the effect of any elections under section 168(k) or section 1400L(b), as applicable).

(B) *Relinquished automobile section 280F limit* is the limit on depreciation deductions under section 280F(a) for the taxable year based on when the relinquished MACRS passenger automobile was placed in service by the taxpayer.

(ii) *Order in which limitations on depreciation under section 280F(a) are applied.* Generally, depreciation deductions allowable under section 280F(a) reduce the basis in the relinquished MACRS passenger automobile and the exchanged basis of

the replacement MACRS passenger automobile, before the excess basis of the replacement MACRS passenger automobile is reduced. The depreciation deductions for the relinquished MACRS passenger automobile in the year of disposition and the replacement MACRS passenger automobile in the year of replacement and each subsequent taxable year are allowable in the following order:

(A) The depreciation deduction allowable for the relinquished MACRS passenger automobile as determined under paragraph (c)(5)(i) of this section for the year of disposition to the extent of the smaller of the replacement automobile section 280F limit and the relinquished automobile section 280F limit, if the year of disposition is the year of replacement. If the year of replacement is a taxable year subsequent to the year of disposition, the depreciation deduction allowable for the relinquished MACRS passenger automobile for the year of disposition is limited to the relinquished automobile section 280F limit.

(B) The additional first year depreciation allowable on the remaining exchanged basis (remaining carryover basis as determined under § 1.168(k)-1T(f)(5) or § 1.1400L(b)-1T(f)(5), as applicable) of the replacement MACRS passenger automobile, as determined under § 1.168(k)-1T(f)(5) or § 1.1400L(b)-1T(f)(5), as applicable, to the extent of the excess of the replacement automobile section 280F limit over the amount allowable under paragraph (d)(3)(ii)(A) of this section.

(C) The depreciation deduction allowable for the taxable year on the depreciable exchanged basis of the replacement MACRS passenger automobile determined under paragraph (c) of this section to the extent of any excess of the sum of the amounts allowable under paragraphs (d)(3)(ii)(A) and (B) of this section over the smaller of the replacement automobile section 280F limit and the relinquished automobile section 280F limit.

(D) Any section 179 deduction allowable in the year of replacement on the excess basis of the replacement MACRS passenger automobile to the extent of the excess of the replacement automobile section 280F limit over the sum of the amounts allowable under paragraphs (d)(3)(ii)(A), (B), and (C) of this section.

(E) The additional first year depreciation allowable on the remaining excess basis of the replacement MACRS passenger automobile, as determined under § 1.168(k)-1T(f)(5) or § 1.1400L(b)-1T(f)(5), as applicable, to the extent of the excess of the

replacement automobile section 280F limit over the sum of the amounts allowable under paragraphs (d)(3)(ii)(A), (B), (C), and (D) of this section.

(F) The depreciation deduction allowable under paragraph (d) of this section for the depreciable excess basis of the replacement MACRS passenger automobile to the extent of the excess of the replacement automobile section 280F limit over the sum of the amounts allowable under paragraphs (d)(3)(ii)(A), (B), (C), (D), and (E) of this section.

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

Example 1. H, a calendar-year taxpayer, acquired and placed in service Automobile X in January 2000 for \$30,000 to be used solely for H's business. In December 2003, H exchanges, in a like-kind exchange, Automobile X plus \$15,000 cash for new Automobile Y that will also be used solely in H's business. Automobile Y is 50-percent bonus depreciation property for purposes of section 168(k)(4). Both automobiles are depreciated using the double declining balance method, the half-year convention, and a five-year recovery period. The relinquished automobile section 280F limit for 2003 for Automobile X is \$1,775. The replacement automobile section 280F limit for Automobile Y is \$10,710. The exchanged basis for Automobile Y is \$17,315 (\$30,000 less total depreciation allowable of \$12,685 ((\$3,060 for 2000, \$4,900 for 2001, \$2,950 for 2002, and \$1,775 for 2003)). Without taking section 280F into account, the additional first year depreciation deduction for the remaining exchanged basis is \$8,658 (\$17,315 × 0.5). Because this amount is less than \$8,935 (\$10,710 (the replacement automobile section 280F limit for 2003 for the Automobile Y) - \$1,775 (the depreciation allowable for Automobile X for the 2003)) the additional first year depreciation deduction for the exchanged basis is \$8,658. No depreciation deduction is allowable in 2003 for the depreciable exchanged basis because the depreciation deductions taken for Automobile X and the remaining exchanged basis exceed the exchanged automobile section 280F limit. An additional first year depreciation deduction of \$278 is allowable for the excess basis of \$15,000 in Automobile Y. Thus at the end of 2003 the adjusted depreciable basis in Automobile Y is \$23,379 comprised of adjusted depreciable exchanged basis of \$8,657 (\$17,315 (exchanged basis) - \$8,658 (additional first year depreciation for exchanged basis)) and of an adjusted depreciable excess basis of \$14,722 (\$15,000 (excess basis) - \$278 (additional first year depreciation for 2003)).

Example 2. Same facts as in *Example 1*, except that H placed in service Automobile X in January 2002, and H elected not to claim the additional first year depreciation deduction for 5-year property placed in service in 2002 and 2003. The relinquished automobile section 280F limit for Automobile X for 2003 is \$4,900. Because the replacement automobile section 280F limit for 2003 for Automobile Y (\$3,060) is less

than the relinquished automobile section 280F limit for Automobile X for 2003 and is less than \$5,388 ((\$30,000 (cost) - \$3,060 (depreciation allowable for 2002)) × 0.4 × 6/12), the depreciation allowable that would be allowable for Automobile X (determined without regard to section 280F) in the year of disposition, the depreciation for Automobile X in the year of disposition is limited to \$3,060. For 2003 no depreciation is allowable for the excess basis and the exchanged basis in Automobile Y.

Example 3. AB, a calendar-year taxpayer, purchased and placed in service Automobile X1 in February 2000 for \$10,000. X1 is a passenger automobile subject to section 280F(a) and is used solely for AB's business. AB depreciated X1 using a five year recovery period, the double declining balance method and the half-year convention. As of January 1, 2003, the adjusted basis of X1 was \$2,880 (\$10,000 original cost minus \$2,000 depreciation deduction for 2000, minus \$3,200 depreciation deduction for 2001, and \$1,920 depreciation deduction for 2002). In November 2003, AB exchanges, in a like-kind exchange, Automobile X1 plus \$14,000 cash for new Automobile Y1 that will be used solely in AB's business. Automobile Y1 is 50-percent bonus depreciation property for purposes of section 168(k)(4) and qualifies for the expensing election under section 179. Pursuant to paragraph § 1.168(k)-1T(g)(3)(ii) and paragraph (k)(2)(i) of this section, AB decided to apply § 1.168(i)-6T to the exchange of Automobile X1 for Automobile Y1, the replacement MACRS property. AB also makes the election under section 179 for the excess basis of Automobile Y1. AB depreciates Y1 using a five-year recovery period, the double declining balance method and the half-year convention. For 2003, the relinquished automobile section 280F limit for Automobile X1 is \$1,775 and the replacement automobile section 280F limit for 2003 for Automobile Y1 is \$10,710.

(i) The 2003 depreciation deduction for Automobile X1 is \$576. The depreciation deduction calculated for X1 is \$576 (the adjusted depreciable basis of Automobile X1 at the beginning of 2003 of \$2,880 × 40% × ½ year), which is less than the relinquished automobile section 280F limit and the replacement automobile section 280F limit.

(ii) The additional first year depreciation deduction for the exchanged basis is \$1,152. The additional first year depreciation deduction of \$1,152 (remaining exchanged basis of \$2,304 (\$2,880 adjusted basis of Automobile X1 at the beginning of 2003 minus \$576) × 0.5) is less than the replacement automobile section 280F limit minus \$576.

(iii) AB's MACRS depreciation deduction allowable in 2003 for the remaining exchanged basis of \$1,152 is \$47 (the relinquished automobile section 280F limit of \$1,775 less the depreciation deduction of \$576 taken for Automobile X1 less the additional first year depreciation deduction of \$1,152 taken for the exchanged basis) which is less than the depreciation deduction calculated for the depreciable exchanged basis.

(iv) For 2003, AB takes a \$1,400 section 179 deduction for the excess basis of

Automobile Y1. AB must reduce the excess basis of \$14,000 by the section 179 deduction of \$1,400 to determine the remaining excess basis of \$12,600.

(v) For 2003, AB is allowed a 50-percent additional first year depreciation deduction of \$6,300 (the remaining excess basis of \$12,600 multiplied by .50).

(vi) For 2003, AB's depreciation deduction for the depreciable excess basis is limited to \$1,235. The depreciation deduction computed without regard to the replacement automobile section 280F limit is \$1,260 (\$6,300 depreciable excess basis \times 0.4 \times 6/12). However the depreciation deduction for the depreciable excess basis is limited to \$1,235 (\$10,710 (replacement automobile section 280F limit) - \$576 (depreciation deduction for Automobile X1) - \$1,152 (additional first year depreciation deduction for the exchanged basis) - \$47 (depreciation deduction for exchanged basis) - \$1,400 (section 179 deduction) - \$6,300 (additional first year depreciation deduction for remaining excess basis)).

(4) *Replacement MACRS property acquired and placed-in-service before disposition of relinquished MACRS property.* If, in an involuntary conversion, a taxpayer acquires and places in service the replacement MACRS property before the date of disposition of the relinquished MACRS property, the taxpayer depreciates the unadjusted depreciable basis of the replacement MACRS property under section 168 beginning in the taxable year when the replacement MACRS property is placed in service by the taxpayer and by using the applicable depreciation method, recovery period, and convention prescribed under section 168 for the replacement MACRS property at the placed-in-service date. However, at the time of disposition of the relinquished MACRS property, the taxpayer determines the exchanged basis and the excess basis of the replacement MACRS property and begins to depreciate the depreciable exchanged basis of the replacement MACRS property in accordance with paragraph (c) of this section. The depreciable excess basis of the replacement MACRS property continues to be depreciated by the taxpayer in accordance with the first sentence of this paragraph (d)(4). Further, in the year of disposition of the relinquished MACRS property, the taxpayer must include in taxable income the excess of the depreciation deductions allowable on the unadjusted depreciable basis of the replacement MACRS property over the depreciation deductions that would have been allowable to the taxpayer on the depreciable excess basis of the replacement MACRS property from the date the replacement MACRS property was placed in service by the taxpayer (taking into account the applicable

convention) to the time of disposition of the relinquished MACRS property.

(e) *Use of optional depreciation tables—(1) Taxpayer not bound by prior use of table.* If a taxpayer used an optional depreciation table for the relinquished MACRS property, the taxpayer is not required to use an optional table for the depreciable exchanged basis of the replacement MACRS property. Conversely, if a taxpayer did not use an optional depreciation table for the relinquished MACRS property, the taxpayer may use the appropriate table for the depreciable exchanged basis of the replacement MACRS property. If a taxpayer decides not to use the table for the depreciable exchanged basis of the replacement MACRS property, the depreciation allowance for this property for the year of replacement and subsequent taxable years is determined under paragraph (c) of this section. If a taxpayer decides to use the optional depreciation tables, no depreciation deduction is allowable for MACRS property placed in service by the acquiring taxpayer and subsequently exchanged or involuntarily converted by such taxpayer in the same taxable year, and, if, during the same taxable year, MACRS property is placed in service by the acquiring taxpayer, exchanged or involuntarily converted by such taxpayer, and the replacement MACRS property is disposed of by such taxpayer, no depreciation deduction is allowable for either MACRS property.

(2) *Determination of the depreciation deduction—(i) Relinquished MACRS property.* In the year of disposition, the depreciation allowance for the relinquished MACRS property is computed by multiplying the unadjusted depreciable basis (less the amount of the additional first year depreciation deduction allowed or allowable, whichever is greater, under section 168(k) or section 1400L(b), as applicable) of the relinquished MACRS property by the annual depreciation rate (expressed as a decimal equivalent) specified in the appropriate table for the recovery year corresponding to the year of disposition. This product 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 the exchange or involuntary conversion (taking into account the applicable convention) and the denominator of which is 12. However, if the year of disposition is less than 12 months, the depreciation allowance determined under this paragraph (e)(2)(i) must be adjusted for a short taxable year (for further guidance, for example, see Rev. Proc.

89-15 (1989-1 C.B. 816) and § 601.601(d)(2)(ii)(b) of this chapter).

(ii) *Replacement MACRS property—(A) Determination of the appropriate optional depreciation table.* If a taxpayer chooses to use the appropriate optional depreciation table for the depreciable exchanged basis, the depreciation allowances for the depreciable exchanged basis beginning in the year of replacement are determined by choosing the optional depreciation table that corresponds to the recovery period, depreciation method, and convention of the replacement MACRS property determined under paragraph (c) of this section.

(B) *Calculating the depreciation deduction for the replacement MACRS property—(1) The depreciation deduction for the taxable year is computed by first determining the appropriate recovery year in the table identified under paragraph (e)(2)(ii)(A) of this section. The appropriate recovery year for the year of replacement is the same as the recovery year for the year of disposition, regardless of the taxable year in which the replacement property is acquired. For example, if the recovery year for the year of disposition would have been Year 4 in the table that applied before the disposition of the relinquished MACRS property, then the recovery year for the year of replacement is Year 4 in the table identified under paragraph (e)(2)(ii)(A) of this section.*

(2) 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 (e)(2)(ii)(A) of this section (expressed as a decimal equivalent) corresponding to the replacement MACRS property (as determined under paragraph (e)(2)(ii)(A) of this section) for the taxable years beginning with the placed-in-service year of the relinquished MACRS property through the taxable year immediately prior to the year of disposition. The product of the annual depreciation rate and the transaction coefficient is multiplied by the depreciable exchanged basis (taking into account paragraph (e)(2)(i) of this section). In the year of replacement, this product 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 by the acquiring taxpayer during the year of replacement (taking into account the applicable convention) and the denominator of

which is 12. However, if the year of replacement is the year the relinquished MACRS property is placed in service by the acquiring taxpayer, the preceding sentence does not apply. In addition, if the year of replacement is less than 12 months, the depreciation allowance determined under paragraph (e)(2)(ii) of this section must be adjusted for a short taxable year (for further guidance, for example, see Rev. Proc. 89-15 (1989-1 C.B. 816) and § 601.601(d)(2)(ii)(b) of this chapter).

(iii) *Unrecovered basis.* If the replacement MACRS property would have unrecovered depreciable basis after the final recovery year (for example, due to a deferred exchange), the unrecovered basis is an allowable depreciation deduction in the taxable year that corresponds to the final recovery year unless the unrecovered basis is subject to a depreciation limitation such as section 280F.

(3) *Excess basis.* As provided in paragraph (d)(1) of this section, any excess basis in the replacement MACRS property is treated as property that is placed in service by the acquiring taxpayer at the time of replacement. Thus, if the taxpayer chooses to use the appropriate optional depreciation table for the depreciable excess basis in the replacement MACRS property, the depreciation allowances for the depreciable excess basis are determined by multiplying the depreciable excess basis by the annual depreciation rate (expressed as a decimal equivalent) specified in the appropriate table for each taxable year. The appropriate table for the depreciable excess basis is based on the depreciation method, recovery period, and convention applicable to the depreciable excess basis under section 168 at the time of replacement. However, if the year of replacement is less than 12 months, the depreciation allowance determined under this paragraph (e)(3) must be adjusted for a short taxable year (for further guidance, for example, see Rev. Proc. 89-15 (1989-1 C.B. 816) and § 601.601(d)(2)(ii)(b) of this chapter).

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

Example 1. J, a calendar-year taxpayer, acquired 5-year property for \$10,000 and placed it in service in January 2001. J uses the optional tables to depreciate the property. J uses the half-year convention and did not make any elections for the property. In December 2003, J exchanges the 5-year property for used 7-year property in a like-kind exchange. The depreciable exchanged basis of the 7-year property equals the adjusted depreciable basis of the 5-year property at the time of disposition of the

relinquished MACRS property, namely \$3,840 (\$10,000 less \$2,000 depreciation in 2001, \$3,200 depreciation in 2002, and \$960 depreciation in 2003). J must first determine the appropriate optional depreciation table pursuant to paragraph (c) of this section. Since the replacement MACRS property has a longer recovery period and the same depreciation method as the relinquished MACRS property, J uses the optional depreciation table corresponding to a 7-year recovery period, the 200% declining balance method, and the half-year convention (because the 5-year property was depreciated using a half-year convention). Had the replacement MACRS property been placed in service in the same taxable year as the placed-in-service year of the relinquished MACRS property, the depreciation allowance for the replacement MACRS property for the year of replacement would be determined using recovery year 3 of the optional table. The depreciation allowance equals the depreciable exchanged basis (\$3,840) multiplied by the annual depreciation rate for the current taxable year (.1749 for recovery year 3) as modified by the transaction coefficient $[1 / (1 - (.1429 + .2449))]$ which equals 1.6335. Thus, J multiplies \$3,840, its depreciable exchanged basis in the replacement MACRS property, by the product of .1749 and 1.6335, and then by one-half, to determine the depreciation allowance for 2003, \$549. For 2004, J multiplies its depreciable exchanged basis in the replacement MACRS property determined at the time of replacement of \$3,840 by the product of the modified annual depreciation rate for the current taxable year (.1249 for recovery year 4) and the transaction coefficient (1.6335) to determine its depreciation allowance of \$783.

Example 2. K, a calendar-year taxpayer, acquired used Asset V for \$100,000 and placed it in service in January 1999. K depreciated Asset V under the general depreciation system of section 168(a) by using a 5-year recovery period, the 200-percent declining balance method of depreciation, and the half-year convention. In December 2003, as part of the involuntary conversion, Asset V is involuntarily converted due to an earthquake. In October 2005, K purchases used Asset W with the insurance proceeds from the destruction of Asset V and places Asset W in service to replace Asset V. If Asset W had been placed in service when Asset V was placed in service, it would have been depreciated using a 7-year recovery period, the 200-percent declining balance method, and the half-year convention. K uses the optional depreciation tables to depreciate Asset V and Asset W. For 2003 (recovery year 5 on the optional table), the depreciation deduction for Asset V is \$5,760 $(0.1152)(\$100,000)(1/2)$. Thus, the adjusted depreciable basis of Asset V at the time of replacement is \$11,520 (\$100,000 less \$20,000 depreciation in 1999, \$32,000 depreciation in 2000, \$19,200 depreciation in 2001, \$11,520 depreciation in 2002, and \$5,760 depreciation in 2003). Under the table that applied to Asset V, the year of disposition was recovery year 5 and the depreciation deduction was determined under the straight line method. The table that

applies for Asset W is the table that applies the straight line depreciation method, the half-year convention, and a 7-year recovery period. The appropriate recovery year under this table is recovery year 5. The depreciation deduction for Asset W for 2005 is \$1,646 $(\$11,520)(0.1429)(1/(1 - 0.5))(1/2)$. Thus, the depreciation deduction for Asset W in 2006 (recovery year 6) is \$3,290 $(\$11,520)(0.1428)(1/(1 - 0.5))$. The depreciation deduction for 2007 (recovery year 7) is \$3,292 $(\$11,520)(.1429)(1/(1 - .5))$. The depreciation deduction for 2008 (recovery year 8) is \$3292 (\$11,520 less allowable depreciation for Asset W for 2005 through 2007 (\$1,646 + \$3,290 + \$3,292)).

Example 3. L, a calendar-year taxpayer, placed in service used Computer X in January 2002 for \$5,000. L depreciated Computer X under the general depreciation system of section 168(a) by using the 200-percent declining balance method of depreciation, a 5-year recovery period, and the half-year convention. Computer X is destroyed in a fire in March 2004. For 2004, the depreciation deduction allowable for Computer X equals \$480 $(\$5,000)(.1920) \times (1/2)$. Thus, the adjusted depreciable basis of Computer X was \$1,920 when it was destroyed (\$5,000 unadjusted depreciable basis less \$1,000 depreciation for 2002, \$1,600 depreciation for 2003, and \$480 depreciation for 2004). In April 2004, as part of the involuntary conversion, L acquired and placed in service used Computer Y with insurance proceeds received due to loss of Computer X. Computer Y will be depreciated using the same depreciation method, recovery period, and convention as Computer X. L elected to use the optional depreciation tables to compute the depreciation allowance for Computer X and Computer Y. The depreciation deduction allowable for 2004 for Computer Y equals \$384 $(\$1,920 \times (.1920)(1/(1 - .52))) \times (1/2)$.

(f) *Mid-quarter convention.* For purposes of applying the 40-percent test under section 168(d) and the regulations under section 168(d), the following rules apply:

(1) *Exchanged basis.* If, in a taxable year, MACRS property is placed in service by the acquiring taxpayer (but not as a result of a like-kind exchange or involuntary conversion) and—

(i) In the same taxable year, is disposed of by the acquiring taxpayer in a like-kind exchange or an involuntary conversion and replaced by the acquiring taxpayer with replacement MACRS property, the exchanged basis (determined without any adjustments for depreciation deductions during the taxable year) of the replacement MACRS property is taken into account in the year of replacement in the quarter the relinquished MACRS property was placed in service by the acquiring taxpayer; or

(ii) In the same taxable year, is disposed of by the acquiring taxpayer in a like-kind exchange or an involuntary conversion, and in a subsequent taxable

year is replaced by the acquiring taxpayer with replacement MACRS property, the exchanged basis (determined without any adjustments for depreciation deductions during the taxable year) of the replacement MACRS property is taken into account in the year of replacement in the quarter the replacement MACRS property was placed in service by the acquiring taxpayer; or

(iii) In a subsequent taxable year, disposed of by the acquiring taxpayer in a like-kind exchange or involuntary conversion, the exchanged basis of the replacement MACRS property is not taken into account in the year of replacement.

(2) *Excess basis.* Any excess basis is taken into account in the quarter the replacement MACRS property is placed in service by the acquiring taxpayer.

(3) *Depreciable property acquired for nondepreciable property.* Both the exchanged basis and excess basis of the replacement MACRS property described in paragraph (d)(2)(ii) of this section (depreciable property acquired for nondepreciable property), are taken into account for determining whether the mid-quarter convention applies in the year of replacement.

(g) *Section 179 election.* In applying the section 179 election, only the excess basis, if any, in the replacement MACRS property is taken into account. If the replacement MACRS property is described in paragraph (d)(2)(ii) of this section (depreciable property acquired for nondepreciable property), only the excess basis in the replacement MACRS property is taken into account.

(h) *Additional first year depreciation deduction.* See § 1.168(k)-1T(f)(5) (for qualified property or 50-percent bonus depreciation property) and § 1.1400L(b)-1T(f)(5) (for qualified New York Liberty Zone property).

(i) *Election not to apply this section.* A taxpayer may elect not to apply this section for any MACRS property involved in a like-kind exchange or involuntary conversion. An election under this paragraph (i) applies only to the taxpayer making the election and the election applies to both the relinquished MACRS property and the replacement MACRS property. If an election is made under this paragraph (i), the depreciation allowances for the replacement MACRS property beginning in the year of replacement and for the relinquished MACRS property in the year of disposition are not determined under this section. Instead, for depreciation purposes, the exchanged basis and excess basis, if any, in the replacement MACRS property are treated as being placed in service by the

taxpayer at the time of replacement and the adjusted depreciable basis of the relinquished MACRS property is treated as being disposed of by the taxpayer at the time of disposition. Paragraphs (c)(5)(i) (determination of depreciation for relinquished MACRS property in the year of disposition), (c)(5)(iii) (rules for deferred transactions), (g) (section 179 election), and (h) (additional first year depreciation deduction) of this section apply to property to which this paragraph (i) applies. See paragraph (j) of this section for the time and manner of making the election under this paragraph (i).

(j) *Time and manner of making elections—(1) In general.* The election provided in paragraph (i) of this section is made separately by each person acquiring replacement MACRS property. The election is made for each member of a consolidated group by the common parent of the group, by the partnership (and not by the partners separately) in the case of a partnership, or by the S corporation (and not by the shareholders separately) in the case of an S corporation. A separate election under paragraph (i) of this section is required for each like-kind exchange or involuntary conversion. The election provided in paragraph (i) of this section must be made within the time and manner provided in paragraph (j)(2) and (3) of this section and may not be made by the taxpayer in any other manner (for example, the election cannot be made through a request under section 446(e) to change the taxpayer's method of accounting), except as provided in paragraph (k)(2) of this section.

(2) *Time for making election.* The election provided in paragraph (i) of this section is made by the due date (including extensions) of the taxpayer's Federal tax return for the year of replacement.

(3) *Manner of making election.* The election provided in paragraph (i) of this section is made by typing or legibly printing at the top of Form 4562, *Depreciation and Amortization*, "ELECTION MADE UNDER SECTION 1.168(i)-6T(i)," or in the manner provided for on Form 4562 and its instructions. If Form 4562 is revised or renumbered, any reference in this section to that form is treated as a reference to the revised or renumbered form.

(4) *Revocation.* The election provided in paragraph (i) of this section, once made, may be revoked only with the consent of the Commissioner of Internal Revenue. Such consent will be granted only in extraordinary circumstances. Requests for consent are requests for a letter ruling and must be filed with the

Commissioner of Internal Revenue, Washington, DC 20224. Requests for consent may not be made in any other manner (for example, through a request under section 446(e) to change the taxpayer's method of accounting).

(k) *Effective date—(1) In general.* (i) This section applies to a like-kind exchange or an involuntary conversion of MACRS property for which the time of disposition and the time of replacement both occur after February 27, 2004.

(ii) The applicability of this section expires February 27, 2007.

(2) *Application to pre-effective date like-kind exchanges and involuntary conversions.* For a like-kind exchange or an involuntary conversion of MACRS property for which the time of disposition, the time of replacement, or both occur on or before February 27, 2004, a taxpayer may:

(i) Apply the provisions of this section. If a taxpayer's applicable federal income tax return has been filed on or before February 27, 2004, and the taxpayer has treated the replacement MACRS property as acquired, and the relinquished MACRS property as disposed of, in a like-kind exchange or an involuntary conversion, the taxpayer changes its method of accounting for depreciation of the replacement MACRS property and relinquished MACRS property in accordance with this paragraph (k)(2)(i) by following the applicable administrative procedures issued under § 1.446-1T(e)(3)(ii) for obtaining the Commissioner's automatic consent to a change in method of accounting (for further guidance, see Rev. Proc. 2002-9 (2002-1 C.B. 327) and § 601.601(d)(2)(ii)(b) of this chapter); or

(ii) Rely on prior guidance issued by the Internal Revenue Service for determining the depreciation deductions of replacement MACRS property and relinquished MACRS property (for further guidance, for example, see Notice 2000-4 (2001-1 C.B. 313) and § 601.601(d)(2)(ii)(b) of this chapter). In relying on such guidance, a taxpayer may use any reasonable, consistent method of determining depreciation in the year of disposition and the year of replacement. If a taxpayer's applicable federal income tax return has been filed on or before February 27, 2004, and the taxpayer has treated the replacement MACRS property as acquired, and the relinquished MACRS property as disposed of, in a like-kind exchange or an involuntary conversion, the taxpayer changes its method of accounting for depreciation of the replacement MACRS property and relinquished MACRS property in accordance with this

paragraph (k)(2)(ii) by following the applicable administrative procedures issued under § 1.446-1T(e)(3)(ii) for obtaining the Commissioner's automatic consent to a change in method of accounting (for further guidance, see Rev. Proc. 2002-9 (2002-1 C.B. 327) and § 601.601(d)(2)(ii)(b) of this chapter).

■ **Par. 11.** Section 1.168(k)-1T is amended by:

- 1. Revising paragraphs (f)(5)(ii)(F)(2) and (f)(5)(v).
- 2. Redesignating paragraph (g)(1) as paragraph (g)(1)(i).
- 3. Revising the last sentence in newly designated paragraph (g)(1)(i) and redesignating as new paragraph (g)(1)(ii).
- 4. Redesignating paragraph (g)(3) as paragraph (g)(3)(i).
- 5. Adding paragraph (g)(3)(ii).

The addition and revisions read as follows:

§ 1.168(k)-1T Additional first year depreciation (temporary).

* * * * *

(f) * * *
(5) * * *
(ii) * * *
(F) * * *

(2) The time of disposition of the exchanged or involuntarily converted property.

* * * * *

(v) *Examples.* The application of this paragraph (f)(5) is illustrated by the following examples:

Example 1. (i) In December 2002, EE, a calendar-year corporation, acquired for \$200,000 and placed in service Canopy V1, a gas station canopy. Canopy V1 is qualified property under section 168(k)(1) and is 5-year property under section 168(e). EE depreciated Canopy V1 under the general depreciation system of section 168(a) by using the 200-percent declining balance method of depreciation, a 5-year recovery period, and the half-year convention. EE elected to use the optional depreciation tables to compute the depreciation allowance for Canopy V1. On January 1, 2003, Canopy V1 was destroyed in a fire and was no longer usable in EE's business. On June 1, 2003, in an involuntary conversion, EE acquired and placed in service Canopy W1 with all of the \$160,000 of insurance proceeds EE received due to the loss of Canopy V1. Canopy W1 is 50-percent bonus depreciation property under section 168(k)(4) and is 5-year property under section 168(e). Pursuant to paragraph (g)(3)(ii) of this section and § 1.168(i)-6T(k)(2)(i), EE decided to apply § 1.168(i)-6T to the involuntary conversion of Canopy V1 with the replacement of Canopy W1, the acquired MACRS property.

(ii) For 2002, EE is allowed a 30-percent additional first year depreciation deduction of \$60,000 for Canopy V1 (the unadjusted depreciable basis of \$200,000 multiplied by .30), and a regular MACRS depreciation deduction of \$28,000 for Canopy V1 (the remaining adjusted depreciable basis of

\$140,000 multiplied by the annual depreciation rate of .20 for recovery year 1).

(iii) For 2003, EE is allowed a regular MACRS depreciation deduction of \$22,400 for Canopy V1 (the remaining adjusted depreciable basis of \$140,000 multiplied by the annual depreciation rate of .32 for recovery year 2 \times $\frac{1}{2}$ year).

(iv) Pursuant to paragraph (f)(5)(iii)(A) of this section, the additional first year depreciation deduction allowable for Canopy W1 equals \$44,800 (.50 of Canopy W1's remaining carryover basis at the time of replacement of \$89,600 (Canopy V1's remaining adjusted depreciable basis of \$140,000 minus 2002 regular MACRS depreciation deduction of \$28,000 minus 2003 regular MACRS depreciation deduction of \$22,400)).

Example 2. (i) Same facts as in *Example 1*, except EE elected not to deduct the additional first year depreciation for 5-year property placed in service in 2002. EE deducted the additional first year depreciation for 5-year property placed in service in 2003.

(ii) For 2002, EE is allowed a regular MACRS depreciation deduction of \$40,000 for Canopy V1 (the unadjusted depreciable basis of \$200,000 multiplied by the annual depreciation rate of .20 for recovery year 1).

(iii) For 2003, EE is allowed a regular MACRS depreciation deduction of \$32,000 for Canopy V1 (the unadjusted depreciable basis of \$200,000 multiplied by the annual depreciation rate of .32 for recovery year 2 \times $\frac{1}{2}$ year).

(iv) Pursuant to paragraph (f)(5)(iii)(A) of this section, the additional first year depreciation deduction allowable for Canopy W1 equals \$64,000 (.50 of Canopy W1's remaining carryover basis at the time of replacement of \$128,000 (Canopy V1's unadjusted depreciable basis of \$200,000 minus 2002 regular MACRS depreciation deduction of \$40,000 minus 2003 regular MACRS depreciation deduction of \$32,000)).

Example 3. (i) In December 2001, FF, a calendar-year corporation, acquired for \$10,000 and placed in service Computer X2. Computer X2 is qualified property under section 168(k)(1) and is 5-year property under section 168(e). FF depreciated Computer X2 under the general depreciation system of section 168(a) by using the 200-percent declining balance method of depreciation, a 5-year recovery period, and the half-year convention. FF elected to use the optional depreciation tables to compute the depreciation allowance for Computer X2. On January 1, 2002, FF acquired Computer Y2 by exchanging Computer X2 and \$1,000 cash in a like-kind exchange. Computer Y2 is qualified property under section 168(k)(1) and is 5-year property under section 168(e). Pursuant to paragraph (g)(3)(ii) of this section and § 1.168(i)-6T(k)(2)(i), FF decided to apply § 1.168(i)-6T to the exchange of Computer X2 for Computer Y2, the acquired MACRS property.

(ii) For 2001, FF is allowed a 30-percent additional first year depreciation deduction of \$3,000 for Computer X2 (unadjusted basis of \$10,000 multiplied by .30), and a regular MACRS depreciation deduction of \$1,400 for Computer X2 (the remaining adjusted

depreciable basis of \$7,000 multiplied by the annual depreciation rate of .20 for recovery year 1).

(iii) For 2002, FF is allowed a regular MACRS depreciation deduction of \$1,120 for Computer X2 (the remaining adjusted depreciable basis of \$7,000 multiplied by the annual depreciation rate of .32 for recovery year 2 \times $\frac{1}{2}$ year).

(iv) Pursuant to paragraph (f)(5)(iii)(A) of this section, the 30-percent additional first year depreciation deduction for Computer Y2 is allowable for the remaining carryover basis at the time of replacement of \$4,480 (Computer X2's unadjusted depreciable basis of \$10,000 minus additional first year depreciation deduction allowable of \$3,000 minus 2001 regular MACRS depreciation deduction of \$1,400 minus 2002 regular MACRS depreciation deduction of \$1,120) and for the remaining excess basis at the time of replacement of \$1,000 (cash paid for Computer Y2). Thus, the 30-percent additional first year depreciation deduction for the remaining carryover basis at the time of replacement equals \$1,344 (\$4,480 multiplied by .30) and for the remaining excess basis at the time of replacement equals \$300 (\$1,000 multiplied by .30), which totals \$1,644.

Example 4. (i) In September 2002, GG, a June 30 year-end corporation, acquired for \$20,000 and placed in service Equipment X3. Equipment X3 is qualified property under section 168(k)(1) and is 5-year property under section 168(e). GG depreciated Equipment X3 under the general depreciation system of section 168(a) by using the 200-percent declining balance method of depreciation, a 5-year recovery period, and the half-year convention. GG elected to use the optional depreciation tables to compute the depreciation allowance for Equipment X3. In December 2002, GG acquired Equipment Y3 by exchanging Equipment X3 and \$5,000 cash in a like-kind exchange. Equipment Y3 is qualified property under section 168(k)(1) and is 5-year property under section 168(e). Pursuant to paragraph (g)(3)(ii) of this section and § 1.168(i)-6T(k)(2)(i), GG decided to apply § 1.168(i)-6T to the exchange of Equipment X3 for Equipment Y3, the acquired MACRS property.

(ii) Pursuant to paragraph (f)(5)(iii)(B) of this section, no additional first year depreciation deduction is allowable for Equipment X3 and, pursuant to § 1.168(d)-1T(b)(3)(ii), no regular depreciation deduction is allowable for Equipment X3, for the taxable year ended June 30, 2003.

(iii) Pursuant to paragraph (f)(5)(iii)(A) of this section, the 30-percent additional first year depreciation deduction for Equipment Y3 is allowable for the remaining carryover basis at the time of replacement of \$20,000 (Equipment X3's unadjusted depreciable basis of \$20,000) and for the remaining excess basis at the time of replacement of \$5,000 (cash paid for Equipment Y3). Thus, the 30-percent additional first year depreciation deduction for the remaining carryover basis at the time of replacement equals \$6,000 (\$20,000 multiplied by .30) and for the remaining excess basis at the time of replacement equals \$1,500 (\$5,000 multiplied by .30), which totals \$7,500.

Example 5. (i) Same facts as in *Example 4.* GG depreciated Equipment Y3 under the general depreciation system of section 168(a) by using the 200-percent declining balance method of depreciation, a 5-year recovery period, and the half-year convention. GG elected to use the optional depreciation tables to compute the depreciation allowance for Equipment Y3. On July 1, 2003, GG acquired Equipment Z1 by exchanging Equipment Y3 in a like-kind exchange. Equipment Z1 is 50-percent bonus depreciation property under section 168(k)(4) and is 5-year property under section 168(e). Pursuant to paragraph (g)(3)(ii) of this section and § 1.168(i)-6T(k)(2)(i), GG decided to apply § 1.168(i)-6T to the exchange of Equipment Y3 for Equipment Z3, the acquired MACRS property.

(ii) For the taxable year ending June 30, 2003, the regular MACRS depreciation deduction allowable for the remaining carryover basis at the time of replacement (after taking into account the additional first year depreciation deduction) of Equipment Y3 is \$2,800 (the remaining carryover basis at the time of replacement of \$20,000 minus the additional first year depreciation deduction of \$6,000, multiplied by the annual depreciation rate of .20 for recovery year 1) and for the remaining excess basis at the time of replacement (after taking into account the additional first year depreciation deduction) of Equipment Y3 is \$700 (the remaining excess basis at the time of replacement of \$5,000 minus the additional first year depreciation deduction of \$1,500, multiplied by the annual depreciation rate of .20 for recovery year 1), which totals \$3,500.

(iii) For the taxable year ending June 30, 2004, the regular MACRS depreciation deduction allowable for the remaining carryover basis (after taking into account the additional first year depreciation deduction) of Equipment Y3 is \$2,240 (the remaining carryover basis at the time of replacement of \$20,000 minus the additional first year depreciation deduction of \$6,000, multiplied by the annual depreciation rate of .32 for recovery year 2 \times $\frac{1}{2}$ year) and for the remaining excess basis (after taking into account the additional first year depreciation deduction) of Equipment Y3 is \$560 (the remaining excess basis at the time of replacement of \$5,000 minus the additional first year depreciation deduction of \$1,500, multiplied by the annual depreciation rate of .32 for recovery year 2 \times $\frac{1}{2}$ year), which totals \$2,800.

(iv) For the taxable year ending June 30, 2004, pursuant to paragraph (f)(5)(iii)(A) of this section, the 50-percent additional first year depreciation deduction for Equipment Z1 is allowable for the remaining carryover basis at the time of replacement of \$11,200 (Equipment Y3's unadjusted depreciable basis of \$25,000 minus the total additional first year depreciation deduction of \$7,500 minus the total 2003 regular MACRS depreciation deduction of \$3,500 minus the total 2004 regular depreciation deduction (taking into account the half-year convention) of \$2,800). Thus, the 50-percent additional first year depreciation deduction for the remaining carryover basis at the time of

replacement equals \$5,600 (\$11,200 multiplied by .50).

* * * * *

(g) * * * (1) * * * (i) * * *

(ii) Except as provided in paragraph (g)(3)(ii) of this section, the applicability of this section expires on or before September 4, 2006.

(2) * * *

(3) * * * —(i). * * *

(ii) Paragraph (f)(5)(ii)(F)(2) of this section and paragraph (f)(5)(v) of this section apply to a like-kind exchange or an involuntary conversion of MACRS property and computer software for which the time of disposition and the time of replacement both occur after February 27, 2004. For a like-kind exchange or an involuntary conversion of MACRS property for which the time of disposition, the time of replacement, or both occur on or before February 27, 2004, *see* § 1.168(i)-6T(k)(2)(ii). For a like-kind exchange or involuntary conversion of computer software for which the time of disposition, the time of replacement, or both occur on or before February 27, 2004, a taxpayer may rely on prior guidance issued by the Internal Revenue Service for determining the depreciation deductions of the acquired computer software and the exchanged or involuntarily converted computer software (for further guidance, *see* § 1.168(k)-1T(f)(5) published in the **Federal Register** on September 8, 2003 (68 FR 53000)). In relying on such guidance, a taxpayer may use any reasonable, consistent method of determining depreciation in the year of disposition and the year of replacement. The applicability of paragraph (f)(5) of this section expires on or before February 27, 2007.

* * * * *

Mark E. Matthews,

Deputy Commissioner for Services and Enforcement.

Approved: February 17, 2004.

Pamela F. Olson,

Assistant Secretary of the Treasury (Tax Policy).

[FR Doc. 04-3992 Filed 2-27-04; 8:45 am]

BILLING CODE 4830-01-P

DEPARTMENT OF HOMELAND SECURITY

Coast Guard

33 CFR Part 117

[CGD07-03-088]

RIN 1625-AA09

Drawbridge Operation Regulations; Miami River, North Fork, Miami, FL

AGENCY: Coast Guard, DHS.

ACTION: Final rule.

SUMMARY: The Coast Guard is changing the operating regulations and the name of the Seaboard System Railroad Bridge, across the Miami River, mile 5.3, Miami, Florida. This rule requires the bridge to open only after a 48-hour advance notice to the owner. In addition, the Coast Guard is changing the name from Seaboard System Railroad Bridge to the FDOT Railroad Bridge, to reflect the current owner.

DATES: This rule is effective March 31, 2004.

ADDRESSES: Comments and material received from the public, as well as documents indicated in this preamble as being available in the docket, are part of docket (CGD07-03-088) and are available for inspection or copying at Commander (obr), Seventh Coast Guard District, 909 SE. 1st Avenue, Miami, Florida 33131 between 7:30 a.m. and 4 p.m., Monday through Friday, except Federal holidays.

FOR FURTHER INFORMATION CONTACT: Mr. Barry Dragon, Project Manager, Seventh Coast Guard District, Bridge Branch, (305) 415-6743.

SUPPLEMENTARY INFORMATION:

Regulatory History

On August 5, 2003, the Coast Guard published a notice of proposed rulemaking (NPRM) entitled Drawbridge Operation Regulations; Miami River, North Fork, Miami, Florida in the **Federal Register** (68 FR 46139). We received 1 comment on this notice of proposed rulemaking (NPRM). No public hearing was requested, and none was held.

Background and Purpose

The Seaboard System Railroad Bridge across the Miami River, mile 5.3, is a railroad bridge with a vertical clearance of 6 feet at mean high water and a horizontal clearance of 60 feet. The current operating regulations published in 33 CFR 117.307 require the bridge to open on signal from 8:30 a.m. to 5:30 p.m., Monday through Friday. All other times the draw must open on signal if