

- (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 involuntary conversions.

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§ 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 in-

voluntary 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 involuntary 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 involuntary 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, taking into account the applicable convention of the relinquished MACRS property and replacement 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 allowance for Asset T for 2004) and the \$938 depreciation allowance 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 over the sum of the amounts allowable under paragraphs (d)(3)(ii)(A) and (B) of this section of 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 ($\$17,315 \times 0.5$). Because this amount is less than \$8,935 (\$10,710 (the replacement automobile section 280F limit for 2003 for Automobile Y) \$1,775 (the depreciation allowable for Automobile X for 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 \$277 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 \$14,723 (\$15,000 (excess basis) - \$277 (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 ($(\$30,000 \text{ (cost)} - \$3,060 \text{ (depreciation allowable for 2002)}) \times 0.4 \times 6/12$), the depreciation 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 $\$2,880 \times 40\% \times \frac{1}{2}$ 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) \times 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 \$3,292 (\$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 the 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

§ 1.168(j)-1T

26 CFR Ch. I (4-1-05 Edition)

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 on or before February 26, 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).

[T.D. 9115, 69 FR 9537, Mar. 1, 2004; 69 FR 17586, Apr. 5, 2004]

§ 1.168(j)-1T Questions and answers concerning tax-exempt entity leasing rules (temporary).

The following questions and answers concern tax-exempt entity leasing under section 168(j) of the Internal Revenue Code of 1954, as enacted by section 31 of the Tax Reform Act of 1984 ("TRA") (Pub. L. 98-369):

CONSEQUENCES OF TAX-EXEMPT USE STATUS

Q-1. If recovery property is subject to the tax-exempt entity leasing provisions of section 168(j), how must the taxpayer compute the property's recovery deductions?

A-1. The taxpayer must compute the property's recovery deductions in accordance with section 168(j) (1) and (2); that is, the taxpayer must use the straight line method and the specified recovery period. For property other than 18-year real property, the applicable recovery percentages for the specified recovery period are to be determined with reference to the tables contained in Prop. Treas. Reg. § 1.168-2(g)(3)(iv)(A). For 18-year real property for which a 40-year recovery period is required, the applicable recovery percentages are to be determined under the following table: