

Internal Revenue Service, Treasury

§ 1.168(i)-1

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§ 1.168(i)-1 General asset accounts.

(a) *Scope.* This section provides rules for general asset accounts under section 168(i)(4). The provisions of this section apply only to assets for which an election has been made under paragraph (k) of this section.

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

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

(2) *Unadjusted depreciable basis of the general asset account* is the sum of the unadjusted depreciable bases of all assets included in the general asset account.

(3) *Adjusted depreciable basis of the general asset account* is the unadjusted depreciable basis of the general asset account less the adjustments to basis described in sections 1016(a)(2) and (3).

(4) *Expensed cost* is the amount of any allowable credit or deduction treated as a deduction allowable for depreciation or amortization for purposes of section 1245 (for example, a credit allowable under section 30 or a deduction allowable under section 179, 179A, or 190).

(c) *Establishment of general asset accounts—(1) Assets eligible for general asset accounts—(i) General rules.* Assets that are subject to either the general depreciation system of section 168(a) or the alternative depreciation system of section 168(g) may be accounted for in one or more general asset accounts. An asset may be included in a general asset account only to the extent of the asset's unadjusted depreciable basis (for example, if, in 1995, a taxpayer places in service an asset that costs \$20,000 and elects under section 179 to expense \$17,500 of that asset's cost, the unadjusted depreciable basis of the asset is \$2,500 and, therefore, only \$2,500 of the asset's cost may be included in a general asset account). However, an asset is not to be included in a general asset account if the asset is used both in a trade or business (or for the production of income) and in a personal activity at any time during the taxable year in which the asset is first placed in service by the taxpayer.

(ii) *Special rules for assets generating foreign source income—(A)* Assets that generate foreign source income, both United States and foreign source income, or combined gross income of a FSC (as defined in section 922), DISC (as defined in section 992(a)), or possessions corporation (as defined in section 936) and its related supplier, may be included in a general asset account if the requirements of paragraph (c)(2)(i) of this section are satisfied. If, however, the inclusion of these assets in a general asset account results in a substantial distortion of income, the Commissioner may disregard the general asset account election and make any re-allocations of income or expense necessary to clearly reflect income.

(B) A general asset account shall be treated as a single asset for purposes of applying the rules in § 1.861-9T(g)(3) (relating to allocation and apportionment of interest expense under the asset method). A general asset account

that generates income in more than one grouping of income (statutory and residual) is a multiple category asset (as defined in § 1.861-9T(g)(3)(ii)), and the income yield from the general asset account must be determined by applying the rules for multiple category assets as if the general asset account were a single asset.

(2) *Grouping assets in general asset accounts*—(i) *General rules.* If a taxpayer makes the election under paragraph (k) of this section, assets that are subject to the election are grouped into one or more general asset accounts. Assets that are eligible to be grouped into a single general asset account may be divided into more than one general asset account. Each general asset account must include only assets that—

(A) Have the same asset class (for further guidance, see Rev. Proc. 87-56, 1987-2 C.B. 674, and § 601.601(d)(2)(ii)(b) of this chapter);

(B) Have the same applicable depreciation method;

(C) Have the same applicable recovery period;

(D) Have the same applicable convention; and

(E) Are placed in service by the taxpayer in the same taxable year.

(ii) *Special rules.* In addition to the general rules in paragraph (c)(2)(i) of this section, the following rules apply when establishing general asset accounts—

(A) Assets without an asset class, but with the same characteristics described in paragraphs (c)(2)(i)(B), (C), (D), and (E) of this section, may be grouped into a general asset account;

(B) Assets subject to the mid-quarter convention may only be grouped into a general asset account with assets that are placed in service in the same quarter of the taxable year;

(C) Assets subject to the mid-month convention may only be grouped into a general asset account with assets that are placed in service in the same month of the taxable year;

(D) Passenger automobiles for which the depreciation allowance is limited under section 280F(a) must be grouped into a separate general asset account; and

(E) Assets subject to paragraph (h)(2)(iii)(A) of this section (change in

use results in a shorter recovery period and/or a more accelerated depreciation method) for which the depreciation allowance for the year of change (as defined in § 1.168(i)-4(a)) is not determined by using an optional depreciation table must be grouped into a separate general asset account.

(d) *Determination of depreciation allowance*—(1) *In general.* Depreciation allowances are determined for each general asset account by using the applicable depreciation method, recovery period, and convention for the assets in the account. The depreciation allowances are recorded in a depreciation reserve account for each general asset account. The allowance for depreciation under this section constitutes the amount of depreciation allowable under section 167(a).

(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) *Disposition of an asset from a general asset account*—(1) *Scope.* This paragraph (e) provides rules applicable to dispositions of assets included in a general asset account. For purposes of this paragraph (e), an asset in a general asset account is disposed of when ownership of the asset is transferred or when the asset is permanently withdrawn from use either in the taxpayer's trade or business or in the production of income. A disposition includes the sale, exchange, retirement, physical abandonment, or destruction of an asset. A disposition also occurs when an asset is transferred to a supplies, scrap, or similar account. A disposition

does not include, however, the retirement of a structural component of real property.

(2) *General rules for a disposition*—(i) *No immediate recovery of basis.* Immediately before a disposition of any asset in a general asset account, the asset is treated as having an adjusted basis of zero for purposes of section 1011. Therefore, no loss is realized upon the disposition of an asset from the general asset account. Similarly, where an asset is disposed of by transfer to a supplier, scrap, or similar account, the basis of the asset in the supplier, scrap, or similar account will be zero.

(ii) *Treatment of amount realized.* Any amount realized on a disposition is recognized as ordinary income (notwithstanding any other provision of subtitle A of the Internal Revenue Code (Code)) to the extent the sum of the unadjusted depreciable basis of the general asset account and any expensed cost (as defined in paragraph (b)(4) of this section) for assets in the account exceeds any amounts previously recognized as ordinary income upon the disposition of other assets in the account. The recognition and character of any excess amount realized are determined under other applicable provisions of the Code (other than sections 1245 and 1250 or provisions of the Code that treat gain on a disposition as subject to section 1245 or 1250).

(iii) *Effect of disposition on a general asset account.* The unadjusted depreciable basis and the depreciation reserve of the general asset account are not affected as a result of a disposition of an asset from the general asset account.

(iv) *Coordination with nonrecognition provisions.* For purposes of determining the basis of an asset acquired in a transaction described in paragraph (e)(3)(iii)(B)(4) of this section (relating to certain nonrecognition provisions), the amount of ordinary income recognized under this paragraph (e)(2) is treated as the amount of gain recognized on the disposition.

(v) *Examples.* The following examples illustrate the application of this paragraph (e)(2).

Example 1. (i) *R*, a calendar-year corporation, maintains one general asset account for ten machines. The machines cost a total of

\$10,000 and were placed in service in June 1995. Of the ten machines, one machine costs \$8,200 and nine machines cost a total of \$1,800. Assume this general asset account has a depreciation method of 200 percent declining balance, a recovery period of 5 years, and a half-year convention. *R* does not make a section 179 election for any of the machines. As of January 1, 1996, the depreciation reserve of the account is \$2,000 $[(\$10,000 - \$0) \times 40\% / 2]$.

(ii) On February 8, 1996, *R* sells the machine that cost \$8,200 to an unrelated party for \$9,000. Under paragraph (e)(2)(i) of this section, this machine has an adjusted basis of zero.

(iii) On its 1996 tax return, *R* recognizes the amount realized of \$9,000 as ordinary income because such amount does not exceed the unadjusted depreciable basis of the general asset account (\$10,000), plus any expensed cost for assets in the account (\$0), less amounts previously recognized as ordinary income (\$0). Moreover, the unadjusted depreciable basis and depreciation reserve of the account are not affected by the disposition of the machine. Thus, the depreciation allowance for the account in 1996 is \$3,200 $(\$10,000 - \$2,000) \times 40\%$.

Example 2. (i) The facts are the same as in *Example 1*. In addition, on June 4, 1997, *R* sells seven machines to an unrelated party for a total of \$1,100. In accordance with paragraph (e)(2)(i) of this section, these machines have an adjusted basis of zero.

(ii) On its 1997 tax return, *R* recognizes \$1,000 as ordinary income (the unadjusted depreciable basis of \$10,000, plus the expensed cost of \$0, less the amount of \$9,000 previously recognized as ordinary income). The recognition and character of the excess amount realized of \$100 $(\$1,100 - \$1,000)$ are determined under applicable provisions of the Code other than section 1245 (such as section 1231). Moreover, the unadjusted depreciable basis and depreciation reserve of the account are not affected by the disposition of the machines. Thus, the depreciation allowance for the account in 1997 is \$1,920 $(\$10,000 - \$5,200) \times 40\%$.

(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.

(ii) *Disposition of all assets remaining in a general asset account*—(A) *Optional termination of a general asset account.* Upon the disposition of all of the assets, or the last asset, in a general asset account, a taxpayer may apply this paragraph (e)(3)(ii) to recover the adjusted depreciable basis of the general asset account (rather than having paragraph (e)(2) of this section apply). Under this paragraph (e)(3)(ii), the general asset account terminates and 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 the disposition. The recognition and character of the gain or loss are determined under other applicable provisions of the Code, except that the amount of gain subject to section 1245 (or section 1250) is limited to the excess of the depreciation allowed or allowable for the general asset account, including any expensed cost (or the excess of the additional depreciation allowed or allowable for the general asset account), over any amounts previously recognized as ordinary income under paragraph (e)(2) of this section.

(B) *Example.* The following example illustrates the application of this paragraph (e)(3)(ii).

Example. (i) *T*, a calendar-year corporation, maintains a general asset account for 1,000 calculators. The calculators cost a total of \$60,000 and were placed in service in 1995. Assume this general asset account has a depreciation method of 200 percent declining balance, a recovery period of 5 years, and a half-year convention. *T* does not make a section 179 election for any of the calculators. In 1996, *T* sells 200 of the calculators to an unrelated party for a total of \$10,000 and recognizes the \$10,000 as ordinary income in accordance with paragraph (e)(2) of this section.

(ii) On March 26, 1997, *T* sells the remaining calculators in the general asset account to an unrelated party for \$35,000. *T* chooses to apply paragraph (e)(3)(ii) of this section. As a result, the account terminates and gain or loss is determined for the account.

(iii) On the date of disposition, the adjusted depreciable basis of the account is \$23,040 (unadjusted depreciable basis of \$60,000 less the depreciation allowed or allowable of \$36,960). Thus, in 1997, *T* recognizes gain of \$11,960 (amount realized of \$35,000 less the adjusted depreciable basis of \$23,040). The gain of \$11,960 is subject to section 1245 to the extent of the depreciation allowed or allowable for the account (plus the expensed cost for assets in the account) less the amounts previously recognized as ordinary income (\$36,960 + \$0 - \$10,000 = \$26,960). As a result, the entire gain of \$11,960 is subject to section 1245.

(iii) *Disposition of an asset in a qualifying disposition*—(A) *Optional determination of the amount of gain, loss, or other deduction.* In the case of a qualifying disposition of an asset (described in paragraph (e)(3)(iii)(B) of this section), a taxpayer may apply this paragraph (e)(3)(iii) (rather than having paragraph (e)(2) of this section apply). Under this paragraph (e)(3)(iii), general asset account treatment for the asset terminates as of the first day of the taxable year in which the qualifying disposition occurs, and the amount of gain, loss, or other deduction for the asset is determined by taking into account the asset's adjusted basis. The adjusted basis of the asset at the time of the 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 recognition and character of the gain, loss, or other deduction are determined under other applicable provisions of the Code, except that the amount of gain subject to section 1245 (or section 1250) is limited to the lesser of—

(1) The depreciation allowed or allowable for the asset, including any expensed cost (or the additional depreciation allowed or allowable for the asset); or

(2) The excess of—

(i) The original unadjusted depreciable basis of the general asset account plus, in the case of section 1245 property originally included in the general asset account, any expensed cost; over

(ii) The cumulative amounts of gain previously recognized as ordinary income under either paragraph (e)(2) of this section or section 1245 (or section 1250).

(B) *Qualifying dispositions.* A qualifying disposition is a disposition that does not involve all the assets, or the last asset, remaining in a general asset account and that is—

(1) A direct result of a fire, storm, shipwreck, or other casualty, or from theft;

(2) A charitable contribution for which a deduction is allowable under section 170;

(3) A direct result of a cessation, termination, or disposition of a business, manufacturing or other income producing process, operation, facility, plant, or other unit (other than by transfer to a supplier, scrap, or similar account); or

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

(C) *Effect of a qualifying disposition on a general asset account.* If the taxpayer applies this paragraph (e)(3)(iii) to a qualifying disposition of an asset, then—

(1) The asset is removed from the general asset account as of the first day of the taxable year in which the qualifying disposition occurs;

(2) The unadjusted depreciable basis of the general asset account is reduced by the unadjusted depreciable basis of the asset as of the first day of the taxable year in which the disposition occurs;

(3) The depreciation reserve of the general asset account is reduced by the depreciation allowed or allowable for the asset as of the end of the taxable year immediately preceding the year of disposition, computed by using the depreciation method, recovery period, and convention applicable to the general asset account in which the asset was included; and

(4) For purposes of determining the amount of gain realized on subsequent

dispositions that is subject to ordinary income treatment under paragraph (e)(2)(ii) of this section, the amount of any expensed cost with respect to the asset is disregarded.

(D) *Example.* The provisions of this paragraph (e)(3)(iii) are illustrated by the following example.

Example. (i) Z, a calendar-year corporation, maintains one general asset account for 12 machines. Each machine costs \$15,000 and was placed in service in 1995. Of the 12 machines, nine machines that cost a total of \$135,000 are used in Z's Kentucky plant, and three machines that cost a total of \$45,000 are used in Z's Ohio plant. Assume this general asset account has a depreciation method of 200 percent declining balance, a recovery period of 5 years, and a half-year convention. Z does not make a section 179 election for any of the machines. As of January 1, 1997, the depreciation reserve for the account is \$93,600.

(ii) On May 27, 1997, Z sells its entire manufacturing plant in Ohio to an unrelated party. The sales proceeds allocated to each of the three machines at the Ohio plant is \$5,000. Because this transaction is a qualifying disposition under paragraph (e)(3)(iii)(B)(3) of this section, Z chooses to apply paragraph (e)(3)(iii) of this section.

(iii) For Z's 1997 return, the depreciation allowance for the account is computed as follows. As of December 31, 1996, the depreciation allowed or allowable for the three machines at the Ohio plant is \$23,400. Thus, as of January 1, 1997, the unadjusted depreciable basis of the account is reduced from \$180,000 to \$135,000 (\$180,000 less the unadjusted depreciable basis of \$45,000 for the three machines), and the depreciation reserve of the account is decreased from \$93,600 to \$70,200 (\$93,600 less the depreciation allowed or allowable of \$23,400 for the three machines as of December 31, 1996). Consequently, the depreciation allowance for the account in 1997 is \$25,920 ((\$135,000 - \$70,200) × 40%).

(iv) For Z's 1997 return, gain or loss for each of the three machines at the Ohio plant is determined as follows. The depreciation allowed or allowable in 1997 for each machine is \$1,440 [(((\$15,000 - \$7,800) × 40%) / 2)]. Thus, the adjusted basis of each machine under section 1011 is \$5,760 (the adjusted depreciable basis of \$7,200 removed from the account less the depreciation allowed or allowable of \$1,440 in 1997). As a result, the loss recognized in 1997 for each machine is \$760 (\$5,000 - \$5,760), which is subject to section 1231.

(v) *Transactions subject to section 168(i)(7).* If an asset in a general asset account is transferred in a transaction

described in section 168(i)(7)(B) (pertaining to treatment of transferees in certain nonrecognition transactions), the transferor must remove the transferred asset from the general asset account as of the first day of the taxable year in which the transaction occurs. In addition, the adjustments to the general asset account described in paragraph (e)(3)(iii)(C)(2) through (4) of this section must be made. The transferee is bound by the transferor's election under paragraph (k) of this section with respect to so much of the asset's basis in the hands of the transferee as does not exceed the asset's adjusted basis in the hands of the transferor. If all of the assets, or the last asset, in a general asset account are transferred, the transferee's basis in the assets or asset transferred is equal to the adjusted depreciable basis of the general asset account as of the beginning of the transferor's taxable year in which the transaction occurs, decreased by the amount of depreciation allocable to the transferor for the year of the transfer.

(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 § 1.168-6(b)(11)) or in an involuntary conversion (as defined under § 1.168-6(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)-6(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)-6(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)-6(b)(2)) in the year of disposition is determined under § 1.168(i)-6. 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)-6(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)-6(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)-6(b)(2)) in the year of disposition is determined under § 1.168(i)-6. 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 adjustments to the general asset account described in paragraph (e)(3)(iii)(C)(2) through (4) of this section.

(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).

(ii) *Formula for determining foreign source income, gain, or loss.* The amount of ordinary income, gain, or loss recognized on the disposition that shall be treated as foreign source income, gain,

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or loss must be determined under the formula in this paragraph (f)(2)(ii). For purposes of this formula, the allowed depreciation deductions are determined

for the applicable time period provided in paragraph (f)(2)(i) of this section. The formula is:

$$\begin{array}{l} \text{Foreign Source Income,} \\ \text{Gain, or Loss} \\ \text{from the Disposition} \\ \text{of an Asset} \end{array} = \begin{array}{l} \text{Total Ordinary Income,} \\ \text{Gain, or Loss} \\ \text{from Disposition} \\ \text{of an Asset} \end{array} \times \begin{array}{l} \text{Allowed Depreciation Deductions} \\ \text{Allocated and Apportioned to} \\ \text{Foreign Source Income/Total} \\ \text{Allowed Depreciation Deductions} \\ \text{for the General Asset Account} \\ \text{or for the Disposed Asset} \\ \text{(as applicable)} \end{array}$$

(3) *Section 904(d) separate categories.* If the assets in the general asset account generate foreign source income in more than one separate category under section 904(d)(1) or another section of the Code (for example, income treated as foreign source income under section 904(g)(10)), or under a United States income tax treaty that requires the foreign tax credit limitation to be determined separately for specified types of income, the amount of “foreign source

income, gain, or loss from the disposition of an asset” (as determined under the formula in paragraph (f)(2)(ii) of this section) must be allocated and apportioned to the applicable separate category or categories under the formula in this paragraph (f)(3). For purposes of this formula, the allowed depreciation deductions are determined for the applicable time period provided in paragraph (f)(2)(i) of this section. The formula is:

$$\begin{array}{l} \text{Foreign Source Income,} \\ \text{Gain, or Loss} \\ \text{In a Separate} \\ \text{Category} \end{array} = \begin{array}{l} \text{Foreign Source Income,} \\ \text{Gain, or Loss} \\ \text{from the Disposition} \\ \text{of an Asset} \end{array} \times \begin{array}{l} \text{Allowed Depreciation Deductions} \\ \text{Allocated and Apportioned to a} \\ \text{Separate Category/Total} \\ \text{Allowed Depreciation Deductions} \\ \text{and Apportioned to} \\ \text{Foreign Source Income} \end{array}$$

(g) *Assets subject to recapture.* If the basis of an asset in a general asset account is increased as a result of the recapture of any allowable credit or deduction (for example, the basis adjustment for the recapture amount under section 30(d)(2), 50(c)(2), 179(d)(10), or 179A(e)(4)), general asset account treatment for the asset terminates as of the first day of the taxable year in which the recapture event occurs. Consequently, the taxpayer must remove the asset from the general asset account as of that day and must make the adjustments to the general asset account described in paragraph (e)(3)(iii)(C)(2) through (4) of this section.

(h) *Changes in use—(1) Conversion to personal use.* An asset in a general asset account becomes ineligible for general asset account treatment if a taxpayer uses the asset in a personal activity during a taxable year. Upon a conversion to personal use, the taxpayer must remove the asset from the general asset account as of the first day of the taxable year in which the change in use occurs (the year of change) and must make the adjustments to the general asset account described in paragraph (e)(3)(iii)(C)(2) through (4) of this section.

(2) *Change in use results in a different recovery period and/or depreciation method—(i) No effect on general asset account*

election. A change in the use described in §1.168(i)-4(d) (change in use results in a different recovery period and/or depreciation method) of an asset in a general asset account shall not cause or permit the revocation of the election made under this section.

(ii) *Asset is removed from the general asset account.* Upon a change in the use described in §1.168(i)-4(d), the taxpayer must remove the asset from the general asset account as of the first day of the year of change and must make the adjustments to the general asset account described in paragraphs (e)(3)(iii)(C)(2) through (4) of this section. If, however, the result of the change in use is described in §1.168(i)-4(d)(3) (change in use results in a shorter recovery period and/or a more accelerated depreciation method) and the taxpayer elects to treat the asset as though the change in use had not occurred pursuant to §1.168(i)-4(d)(3)(ii), no adjustment is made to the general asset account upon the change in use.

(iii) *New general asset account is established—(A) Change in use results in a shorter recovery period and/or a more accelerated depreciation method.* If the result of the change in use is described in §1.168(i)-4(d)(3) (change in use results in a shorter recovery period and/or a more accelerated depreciation method) and adjustments to the general asset account are made pursuant to paragraph (h)(2)(ii) of this section, the taxpayer must establish a new general asset account for the asset in the year of change in accordance with the rules in paragraph (c) of this section, except that the adjusted depreciable basis of the asset as of the first day of the year of change is included in the general asset account. For purposes of paragraph (c)(2) of this section, the applicable depreciation method, recovery period, and convention are determined under §1.168(i)-4(d)(3)(i).

(B) *Change in use results in a longer recovery period and/or a slower depreciation method.* If the result of the change in use is described in §1.168(i)-4(d)(4) (change in use results in a longer recovery period and/or a slower depreciation method), the taxpayer must establish a separate general asset account for the asset in the year of change in accordance with the rules in paragraph

(c) of this section, except that the unadjusted depreciable basis of the asset, and the greater of the depreciation of the asset allowed or allowable in accordance with section 1016(a)(2), as of the first day of the year of change are included in the newly established general asset account. Consequently, this general asset account as of the first day of the year of change will have a beginning balance for both the unadjusted depreciable basis and the depreciation reserve of the general asset account. For purposes of paragraph (c)(2) of this section, the applicable depreciation method, recovery period, and convention are determined under §1.168(i)-4(d)(4)(ii).

(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) *Election—(1) Irrevocable election.* If a taxpayer makes an election under this paragraph (k), the taxpayer consents to, and agrees to apply, all of the provisions of this section to the assets included in a general asset account. Except as provided in paragraph (c)(1)(ii)(A), (e)(3), (g), or (h) of this section, an election made under this section is irrevocable and will be binding on the taxpayer for computing taxable income for the taxable year for which the election is made and for all subsequent taxable years. An election under this paragraph (k) is made separately by each person owning an asset to which this section applies (for example,

by each member of a consolidated group, at the partnership level (and not by the partner separately), or at the S corporation level (and not by the shareholder separately)).

(2) *Time for making election.* The election to apply this section shall be made on the taxpayer's timely filed (including extensions) income tax return for the taxable year in which the assets included in the general asset account are placed in service by the taxpayer.

(3) *Manner of making election.* In the year of election, a taxpayer makes the election under this section by typing or legibly printing at the top of the Form 4562, "GENERAL ASSET ACCOUNT ELECTION MADE UNDER SECTION 168(i)(4)," or in the manner provided for on Form 4562 and its instructions. The taxpayer shall maintain records (for example, "General Asset Account #1 - all 1995 additions in asset class 00.11 for Salt Lake City, Utah facility") that identify the assets included in each general asset account, that establish the unadjusted depreciable basis and depreciation reserve of the general asset account, and that reflect the amount realized during the taxable year upon dispositions from each general asset account. (But see section 179(c) and § 1.179-5 for the record-keeping requirements for section 179 property.) The taxpayer's record-keeping practices should be consistently applied to the general asset accounts. If Form 4562 is revised or renumbered, any reference in this section to that form shall be treated as a reference to the revised or renumbered form.

(1) *Effective dates—(1) In general.* Except as provided in paragraphs (1)(2) and (1)(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) *Exceptions—(i) In general.* (A) Paragraph (b)(1) of this section applies on or after June 17, 2004. For the applicability of § 1.168(i)-1(b)(1) before June 17, 2004, see § 1.168(i)-1(b)(1) in effect

prior to June 17, 2004 (§ 1.168(i)-1(b)(1) as contained in 26 CFR part 1 edition revised as of April 1, 2004).

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

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

(B) *Automatic consent to change method of accounting.* A taxpayer changing its method of accounting in accordance with this paragraph (1)(2)(ii) must follow the applicable administrative procedures issued under § 1.446-1(e)(3)(ii)

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

(3) *Like-kind exchanges and involuntary conversions.* This section applies for an asset transferred by a taxpayer in a like-kind exchange (as defined under § 1.168-6(b)(11)) or in an involuntary conversion (as defined under § 1.168-6(b)(12)) for which the time of disposition (as defined in § 1.168(i)-6(b)(3)) and the time of replacement (as defined in § 1.168(i)-6(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).

[T.D. 8566, 59 FR 51371, Oct. 11, 1994; 59 FR 64849, Dec. 16, 1994, as amended by T.D. 9115, 69 FR 9534, Mar. 1, 2004; T.D. 9132, 69 FR 33842, June 17, 2004; T.D. 9314, 72 FR 9249, Mar. 1, 2007]

§ 1.168(i)-2 Lease term.

(a) *In general.* For purposes of section 168, a lease term is determined under all the facts and circumstances. Paragraph (b) of this section and § 1.168(j)-1T, Q&A 17, describe certain circumstances that will result in a period of time not included in the stated duration of an original lease (additional period) nevertheless being included in the lease term. These rules do not prevent the inclusion of an additional period in the lease term in other circumstances.

(b) *Lessee retains financial obligation—*
(1) *In general.* An additional period of time during which a lessee may not continue to be the lessee will nevertheless be included in the lease term if the lessee (or a related person)—

(i) Has agreed that one or both of them will or could be obligated to make a payment of rent or a payment in the nature of rent with respect to such period; or

(ii) Has assumed or retained any risk of loss with respect to the property for such period (including, for example, by holding a note secured by the property).

(2) *Payments in the nature of rent.* For purposes of paragraph (b)(1)(i) of this section, a payment in the nature of rent includes a payment intended to substitute for rent or to fund or supplement the rental payments of another. For example, a payment in the nature of rent includes a payment of any kind (whether denominated as supplemental rent, as liquidated damages, or otherwise) that is required to be made in the event that—

(i) The leased property is not leased for the additional period;

(ii) The leased property is leased for the additional period under terms that do not satisfy specified terms and conditions;

(iii) There is a failure to make a payment of rent with respect to such additional period; or

(iv) Circumstances similar to those described in paragraph (b)(2) (i), (ii), or (iii) of this section occur.

(3) *De minimis rule.* For the purposes of this paragraph (b), obligations to make de minimis payments will be disregarded.

(c) *Multiple leases or subleases.* If property is subject to more than one lease (including any sublease) entered into as part of a single transaction (or a series of related transactions), the lease term includes all periods described in one or more of such leases. For example, if one taxable corporation leases property to another taxable corporation for a 20-year term and, as part of the same transaction, the lessee subleases the property to a tax-exempt entity for a 10-year term, then the lease term of the property for purposes of