

SUPPLEMENTARY INFORMATION:**Background**

This document contains proposed amendments to 26 CFR part 1 to provide regulations under section 168(i)(5) of the Internal Revenue Code (Code). In addition, these proposed amendments provide change-in-use rules for assets in a general asset account under section 168(i)(4). Sections 168(i)(4) and 168(i)(5) were amended by section 201 of the Tax Reform Act of 1986 (Public Law 99-514, 100 Stat. 2121).

Explanation of Provisions*Scope*

The proposed regulations provide the rules for determining the annual depreciation allowance under section 168 for property for which the use changes in the hands of the taxpayer. Changes in use include a conversion of personal use property to a business or income-producing use, a conversion of MACRS property to personal use, or a change in use of MACRS property that results in a different recovery period, depreciation method, or both.

Conversion to Business or Personal Use

The proposed regulations provide that personal use property converted to business or income-producing use is treated as being placed in service by the taxpayer on the date of the conversion. Thus, the property is depreciated by using the applicable depreciation method, recovery period, and convention prescribed under section 168 for the property beginning in the taxable year the change of use ("year of change") occurs. The depreciable basis of the property for the year of change is the lesser of its fair market value or adjusted depreciable basis at the time of the conversion.

A conversion of MACRS property from business or income-producing use to personal use is treated as a disposition of the property. Depreciation for the year of change is computed by taking into account the applicable convention. No gain, loss, or depreciation recapture is recognized upon the conversion. See Rev. Rul. 69-487 (1969-2 C.B. 165).

*MACRS Property**Use Changes After Placed-In-Service Year*

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

In general, the proposed regulations provide that a change in the use of MACRS property occurs when the primary use of the MACRS property in the taxable year is different from its primary use in the immediately preceding taxable year. A change in the use of MACRS property also occurs when a taxpayer begins or ceases to use MACRS property predominantly outside the United States, when the property changes to tax-exempt bond financed property, or when the property changes to or from tax-exempt use property or imported property covered by an Executive order, during the taxable year. If a change in the use of MACRS property has occurred, the depreciation allowance for the MACRS property for the year of change is determined as though the change in the use of the MACRS property occurred on the first day of the year of change. The IRS and Treasury Department believe that this rule will help to simplify the computation of depreciation allowances in the year of change and subsequent taxable years. The IRS and Treasury Department invite comments on this rule and on a potential alternative rule that would treat a change in the use of MACRS property as occurring on the first day of the month in which the use changes and would allocate the depreciation allowance for that MACRS property for the year of change based on the number of full months of the old use and of the new use of the MACRS property during the year of change.

The proposed regulations also provide rules for determining the applicable depreciation method, recovery period, and convention used to determine the depreciation allowances for the MACRS property for the year of change and subsequent taxable years. If a change in the use of MACRS property results in a shorter recovery period and/or a more accelerated depreciation method (for example, MACRS property ceases to be used predominantly outside the United States), the adjusted depreciable basis of the property as of the beginning of the year of change is depreciated over the shorter recovery period and/or by the more accelerated depreciation method beginning with the year of change as though the MACRS property is first placed in service in the year of change. Under certain circumstances, this rule may adversely affect taxpayers. For example, under this rule, if a change in the use of MACRS property results in a shorter recovery period, a taxpayer must depreciate that MACRS property over the new shorter recovery period even if the remaining portion of the original longer recovery period is less than the

new shorter recovery period. To avoid this adverse effect, the proposed regulations allow a taxpayer to elect to continue to depreciate the MACRS property for which the new recovery period is shorter or a more accelerated method is allowed as though the change in use had not occurred.

If a change in the use of MACRS property results in a longer recovery period and/or slower depreciation method (for example, MACRS property begins to be used predominantly outside the United States), the adjusted depreciable basis of the property is depreciated over the longer recovery period and/or by the slower depreciation method beginning with the year of change as though the taxpayer originally placed the MACRS property in service with the longer recovery period and/or slower depreciation method. Accordingly, the adjusted depreciable basis of the MACRS property as of the beginning of the year of change is depreciated over the remaining portion of the new, longer recovery period as of the beginning of the year of change.

For MACRS property depreciated under the optional depreciation tables in Rev. Proc. 87-57 (1987-2 C.B. 687) before the change in use, the taxpayer may continue to depreciate the property under the tables after the change in use. However, the taxpayer is not required to do so. If the taxpayer desires to use the optional depreciation tables after a change in the use instead of the formulas (for example, see section 6 of Rev. Proc. 87-57 (1987-2 C.B. at 692)), the proposed regulations provide guidance on choosing the applicable optional depreciation table. If the change in use results in a longer recovery period and/or a slower depreciation method, the proposed regulations also provide guidance on how to modify the calculation involved to compute the depreciation allowances beginning in the year of change.

If a change in the use of MACRS property results in a shorter recovery period and/or more accelerated depreciation method, the taxpayer may use the optional depreciation table that corresponds to the applicable depreciation method, recovery period, and convention, determined as though the property is placed in service in the year of change. Taxpayers should be aware that using this table will result in less depreciation than using the formulas, because the convention is factored into the optional depreciation tables, and taken into account in determining depreciation in the year of change. However, if the formulas are used, the convention is not taken into