

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).

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(l) *Effective date*—(1) *In general.* Except as provided in paragraph (l)(2) 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.* Paragraphs (c)(2)(ii)(E) and (h)(2) of this section apply to any changes in the use of depreciable assets pursuant to § 1.168(i)-4(d) in taxable years ending on or after the date of publication of the final regulations in the **Federal Register**. For any changes in the use of depreciable assets as described in § 1.168(i)-4(d) after December 31, 1986, in taxable years ending before the date of publication of the final regulations in the **Federal Register**, the Internal Revenue Service will allow any reasonable method that is consistently applied to the taxpayer's general asset accounts.

(ii) *Change in method of accounting.* If a taxpayer adopted a method of accounting for general asset account treatment due to a change in the use of depreciable assets and the method 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 sections 446(e) and 481 apply. For any taxable year ending on or after the date of publication of the final regulations in the **Federal Register**, a taxpayer changing its method of accounting in accordance with this paragraph (l)(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) and § 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.

5. Section 1.168(i)-4 is added to read as follows:

**§ 1.168(i)-4 Changes in use.**

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

(b) *Conversion to business or income-producing use*—(1) *Depreciation deduction allowable.* This paragraph (b) applies to property that is converted from personal use to use in a taxpayer's trade or business, or for the production of income, during a taxable year. This conversion includes property that was previously used by the taxpayer for personal purposes, including real property (other than land) that is acquired before 1987 and converted from personal use to business or income-producing use after 1986, and depreciable property that was previously used by a tax-exempt entity before it changed to a taxable entity. Upon a conversion to business or income-producing use, the depreciation allowance for the year of change and any subsequent taxable year is determined as though the property is placed in service by the taxpayer on the date on which the conversion occurs. Thus, the taxpayer may choose any applicable depreciation method, recovery period, and convention prescribed under section 168 for the property in the year of change, consistent with any election made under section 168 by the taxpayer for that year (see, for example, section 168(b)(5)). The depreciable basis of the property for the year of change is the lesser of its fair market value or its adjusted depreciable basis, as applicable, at the time of the conversion to business or income-producing use.

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

*Example.* A, a calendar-year taxpayer, purchases a house in 1985 that she occupies as her principal residence. In February 2003, A ceases to occupy the house and converts it to residential rental property. At the time of the conversion to residential rental property, the house's fair market value (excluding land) is \$130,000 and adjusted depreciable basis attributable to the house (excluding land) is \$150,000. Pursuant to this paragraph (b), A is considered to have placed in service residential rental property in

February 2003 with a depreciable basis of \$130,000. A depreciates the residential rental property under the general depreciation system by using the straight-line method, a 27.5-year recovery period, and the mid-month convention. This property is not eligible for the additional first year depreciation deduction provided by section 168(k) or section 1400L(b). Thus, the depreciation allowance for the house for 2003 is \$4,137, after taking into account the mid-month convention ((\$130,000 adjusted depreciable basis multiplied by the applicable depreciation rate of 3.636% (1/27.5)) multiplied by the mid-month convention fraction of 10.5/12). The amount of depreciation computed under section 168, however, may be limited under other provisions of the Internal Revenue Code, such as, section 280A.

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

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