

system changes from 7 years to 5 years. The depreciation method does not change. On January 1, 2003, the adjusted depreciable basis of the equipment is \$22,311. *X* depreciates its 5-year recovery property placed in service in 2003 under the general depreciation system by using the 200-percent declining balance method and a 5-year recovery period. *X* does not use the optional depreciation tables.

(ii) Under paragraph (d)(3)(i) of this section, *X*'s allowable depreciation deduction for the equipment for 2003 and subsequent taxable years is determined as though *X* placed the equipment in service in 2003 for use primarily in its *B* business. The depreciable basis of the equipment as of January 1, 2003, is \$22,311 (the adjusted depreciable basis at January 1, 2003). Because *X* does not use the optional depreciation tables, the depreciation allowance for 2003 (the deemed placed-in-service year) for this equipment only is computed without taking into account the half-year convention. This equipment is not eligible for the additional first year depreciation deduction provided by section 168(k) or section 1400L(b). Thus, *X*'s allowable depreciation deduction for the equipment for 2003 is \$8,924 (\$22,311 adjusted depreciable basis at January 1, 2003, multiplied by the applicable depreciation rate of 40% (200/5)). *X*'s allowable depreciation deduction for the equipment for 2004 is \$5,355 (\$13,387 adjusted depreciable basis at January 1, 2004 multiplied by the applicable depreciation rate of 40% (200/5)).

(iii) Alternatively, under paragraph (d)(3)(ii) of this section, *X* may elect to disregard the change in use and, as a result, may continue to treat the equipment as though it is used primarily in its *A* business. If the election is made, *X*'s allowable depreciation deduction for the equipment for 2003 is \$8,924 (\$22,311 adjusted depreciable basis at January 1, 2003, multiplied by the applicable depreciation rate of 40% (1/2.5 years remaining at January 1, 2003)). *X*'s allowable depreciation deduction for the equipment for 2004 is \$8,925 (\$13,387 adjusted depreciable basis at January 1, 2004 multiplied by the applicable depreciation rate of 66.67% (1/1.5 years remaining at January 1, 2004)).

*Example 2. Change in use results in a shorter recovery period and/or a more accelerated depreciation method and optional depreciation table is used*—(i) Same facts as in *Example 1*, except that *X* used the optional depreciation tables for computing depreciation for 1998 through 2002. Pursuant to paragraph (d)(5) of this section, *X* chooses to continue to use the optional depreciation table for the equipment. *X* does not make the election provided in paragraph (d)(3)(ii) of this section to disregard the change in use.

(ii) In accordance with paragraph (d)(5)(ii)(A) of this section, *X* must first identify the appropriate optional depreciation table for the equipment. This table is table 1 in Rev. Proc. 87-57 because the equipment will be depreciated in the year of change (2003) under the general depreciation system using the 200-percent declining balance method, a 5-year recovery period, and the half-year convention (which is the convention that applied to the

equipment in 1998). This equipment is not eligible for the additional first year depreciation deduction provided by section 168(k) or section 1400L(b). For 2003, *X* multiplies its adjusted depreciable basis in the equipment as of January 1, 2003, of \$22,311, by the annual depreciation rate in table 1 for recovery year 1 for a 5-year recovery period (.20), to determine the depreciation allowance of \$4,462. For 2004, *X* multiplies its adjusted depreciable basis in the equipment as of January 1, 2003, of \$22,311, by the annual depreciation rate in table 1 for recovery year 2 for a 5-year recovery period (.32), to determine the depreciation allowance of \$7,140.

*Example 3. Change in use results in a longer recovery period and/or a slower depreciation method*—(i) *Y*, a calendar-year corporation, places in service in January 2001, equipment at a cost of \$100,000 and uses this equipment in 2001 and 2002 only within the United States. *Y* depreciates the equipment for 2001 and 2002 under the general depreciation system by using the 200-percent declining balance method, a 5-year recovery period, and a half-year convention. Beginning in 2003, *Y* uses the equipment predominantly outside the United States. As a result of this change in use, the equipment is subject to the alternative depreciation system beginning in 2003. Under the alternative depreciation system, the equipment is depreciated by using the straight-line method and a 9-year recovery period. The adjusted depreciable basis of the equipment at January 1, 2003, is \$48,000.

(ii) Pursuant to paragraph (d)(4) of this section, *Y*'s allowable depreciation deduction for 2003 and subsequent taxable years is determined as though the equipment had been placed in service in January 2001, as property used predominantly outside the United States. In determining the applicable depreciation rate for 2003, the applicable depreciation method is the straight-line method and the applicable recovery period is 7.5 years, which is the number of years remaining at January 1, 2003, for property placed in service in 2001 with a 9-year recovery period (taking into account the half-year convention). Thus, the depreciation allowance for 2003 is \$6,398 (\$48,000 adjusted depreciable basis at January 1, 2003, multiplied by the applicable depreciation rate of 13.33% (1/7.5 years)). The depreciation allowance for 2004 is \$6,398 (\$41,602 adjusted depreciable basis at January 1, 2004, multiplied by the applicable depreciation rate of 15.38% (1/6.5 years remaining at January 1, 2004)).

*Example 4. Change in use results in a longer recovery period and/or a slower depreciation method and optional depreciation table is used*—(i) Same facts as in *Example 3*, except that *Y* used the optional depreciation tables for computing depreciation in 2001 and 2002. Pursuant to paragraph (d)(5) of this section, *Y* chooses to continue to use the optional depreciation table for the equipment.

(ii) In accordance with paragraph (d)(5)(ii)(B) of this section, *Y* must first determine the appropriate optional depreciation table for the equipment pursuant to paragraph (d)(5)(ii)(B)(1) of this

section. This table is table 8 in Rev. Proc. 87-57, which corresponds to the alternative depreciation system, the straight-line method, a 9-year recovery period, and the half-year convention (because *Y* depreciated 5-year property in 2001 using a half-year convention). Next, *Y* must determine the appropriate recovery year in table 8. Because the year of change is 2003, the depreciation allowance for the equipment for 2003 is determined using recovery year 3 of table 8. For 2003, *Y* multiplies its adjusted depreciable basis in the equipment as of January 1, 2003, of \$48,000, by the product of the annual depreciation rate in table 8 for recovery year 3 for a 9-year recovery period (.1111) and the transaction coefficient  $[1/(1-(.0556+.1111))]$ , which equals 1.200], to determine the depreciation allowance of \$6,399. For 2004, *Y* multiplies its adjusted depreciable basis in the equipment as of January 1, 2003, of \$48,000, by the product of the annual depreciation rate in table 8 for recovery year 4 for a 9-year recovery period (.1111) and the transaction coefficient (1.200), to determine the depreciation allowance of \$6,399.

(e) *Change in the use of MACRS property during the placed-in-service year*—(1) *In general*. Except as provided in paragraph (e)(2) of this section, if a change in the use of MACRS property occurs during the placed-in-service year and the property continues to be MACRS property owned by the same taxpayer, the depreciation allowance for that property for the placed-in-service year is determined by its primary use during that year. The primary use of MACRS property may be determined in any reasonable manner that is consistently applied to the taxpayer's MACRS property. For purposes of this paragraph (e), the determination of whether the mid-quarter convention applies to any MACRS property placed in service during the year of change is made in accordance with § 1.168(d)-1.

(2) *Alternative depreciation system property*—(i) *Property used within and outside the United States*. The depreciation allowance for the placed-in-service year for MACRS property that is used within and outside the United States is determined by its predominant use during that year. The determination of whether MACRS property is used predominantly outside the United States during the placed-in-service year shall be made in accordance with the test in § 1.48-1(g)(1)(i) for determining predominant use.

(ii) *Tax-exempt bond financed property*. The depreciation allowance for the placed-in-service year for MACRS property that changes to tax-exempt bond financed property, as described in section 168(g)(1)(C) and (g)(5), during that taxable year is determined under the alternative depreciation system. For purposes of