

this paragraph (e), MACRS property changes to tax-exempt bond financed property when a tax-exempt bond is first issued after the MACRS property is placed in service. MACRS property continues to be tax-exempt bond financed property in the hands of the taxpayer even if the tax-exempt bond (including any refunding issue) is not outstanding at, or is redeemed by, the end of the placed-in-service year.

(iii) *Other mandatory alternative depreciation system property.* The depreciation allowance for the placed-in-service year for MACRS property that changes to, or changes from, property described in section 168(g)(1)(B) (tax-exempt use property) or (D) (imported property covered by an Executive Order) during that taxable year is determined under—

(A) The alternative depreciation system if the MACRS property is described in section 168(g)(1)(B) or (D) at the end of the placed-in-service year; or

(B) The general depreciation system if the MACRS property is not described in section 168(g)(1)(B) or (D) at the end of the placed-in-service year.

(3) *Examples.* The application of this paragraph (e) is illustrated by the following examples:

Example 1. (i) *Z*, a utility and calendar-year corporation, places in service on January 1, 2003, equipment at a cost of \$100,000. *Z* uses this equipment in its combustion turbine production plant for 4 months and then uses the equipment in its steam production plant for the remainder of 2003. *Z*'s combustion turbine production plant assets are classified as 15-year property and are depreciated by *Z* under the general depreciation system using a 15-year recovery period and the 150-percent declining balance method of depreciation. *Z*'s steam production plant assets are classified as 20-year property and are depreciated by *Z* under the general depreciation system using a 20-year recovery period and the 150-percent declining balance method of depreciation. *Z* uses the optional depreciation tables. The equipment is qualified property for purposes of section 168(k)(1).

(ii) Pursuant to this paragraph (e), *Z* must determine depreciation based on the primary use of the equipment during the placed-in-service year. *Z* has consistently determined the primary use of all of its MACRS property by comparing the number of full months in the taxable year during which a MACRS property is used in one manner with the number of full months in that taxable year during which that MACRS property is used in another manner. Applying this approach, *Z* determines the depreciation allowance for the equipment for 2003 is based on the equipment being classified as 20-year property because the equipment was used by *Z* in its steam production plant for 8 months in 2003. If the half-year convention applies in 2003, the appropriate optional

depreciation table is table 1 in Rev. Proc. 87-57, which is the table for MACRS property subject to the general depreciation system, the 150-percent declining balance method, a 20-year recovery period, and the half-year convention. Thus, the depreciation allowance for the equipment for 2003 is \$32,625, which is the total of \$30,000 for the additional 30-percent first-year depreciation deduction allowable (the unadjusted depreciable basis of \$100,000 multiplied by .30), plus \$2,625 for the 2003 depreciation allowance on the remaining basis of \$70,000 [(the unadjusted depreciable basis of \$100,000 less the additional first-year depreciation deduction of \$30,000) multiplied by the annual depreciation rate of .0375 in table 1 for recovery year 1 for a 20-year recovery period].

Example 2. *T*, a calendar year corporation, places in service on January 1, 2003, several computers at a total cost of \$100,000. *T* uses these computers within the United States for 3 months in 2003 and then moves and uses the computers outside the United States for the remainder of 2003. Pursuant to § 1.48-1(g)(1)(i), the computers are considered as used predominantly outside the United States in 2003. As a result, for 2003, the computers are required to be depreciated under the alternative depreciation system of section 168(g) with a recovery period of 5 years pursuant to section 168(g)(3)(C). *T* uses the optional depreciation tables. If the half-year convention applies in 2003, the appropriate optional depreciation table is table 8 in Rev. Proc. 87-57, which is the table for MACRS property subject to the alternative depreciation system, the straight-line method, a 5-year recovery period, and the half-year convention. Thus, the depreciation allowance for the computers for 2003 is \$10,000, which is equal to the unadjusted depreciable basis of \$100,000 multiplied by the annual depreciation rate of .10 in table 8 for recovery year 1 for a 5-year recovery period. Because the computers are required to be depreciated under the alternative depreciation system in their placed-in-service year, the computers are not eligible for the additional first year depreciation deduction provided by section 168(k).

(f) *No change in accounting method.* A change in computing the depreciation allowance in the year of change for property subject to this section results from a change in underlying facts and, thus, is not a change in method of accounting under section 446(e).

(g) *Effective date—(1) In general.* This section applies to changes in the use of MACRS property in taxable years ending on or after the date of publication of the final regulations in the **Federal Register**. For changes in the use of MACRS property 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 of depreciating the property under section 168 in the year of change and the subsequent taxable

years that is consistently applied to any property that changed use in the hands of the taxpayer.

(2) *Change in method of accounting—(i) In general.* If a taxpayer adopted a method of accounting for depreciation due to a change in the use of MACRS property and the method is not in accordance with the method of accounting for depreciation provided in this section, a change to the method of accounting for depreciation provided in this section is a change in method of accounting to which the provisions of sections 446(e) and 481 and the regulations thereunder apply. Also, a revocation of the election provided in paragraph (d)(3)(ii) of this section to disregard a change in the use is a change in method of accounting to which the provisions of sections 446(e) and 481 and the regulations thereunder apply.

(ii) *Automatic consent to change method of accounting.* 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 (g)(2) 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). Any change in method of accounting made under this paragraph (g)(2) must be made using an adjustment under section 481(a).

Robert E. Wenzel,

Deputy Commissioner for Services and Enforcement.

[FR Doc. 03-18325 Filed 7-18-03; 8:45 am]

BILLING CODE 4830-01-P

DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Part 1

[REG-162625-02]

RIN 1545-BB73

Real Estate Mortgage Investment Conduits; Application of Section 446 With Respect To Inducement Fees

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking and notice of public hearing.

SUMMARY: This document contains proposed regulations relating to the