

In *Kurzet v. Commissioner*, 222 F.2d 830, 842–845 (10th Cir. 2000), the taxpayer sought to change the classification of property under section 168 from nonresidential real property to 15-year property thereby resulting in a change in recovery period from 31.5 years to 15 years. The Tenth Circuit held that a change in recovery period under section 168 is a change in method of accounting under section 446(e). In reaching its holding, the Tenth Circuit considered the taxpayer's argument that a change in recovery period is analogous to a change in useful life, but concluded that the Commissioner's interpretation of § 1.446–1(e)(2)(ii) in Rev. Proc. 96–31 as requiring a taxpayer to obtain permission for a change in recovery period is not plainly erroneous or inconsistent with § 1.446–1(e)(2)(ii).

In *Brookshire Brothers Holding, Inc. & Subsidiaries v. Commissioner*, 320 F.3d 507 (5th Cir. 2003), *aff'g*. T.C. Memo. 2001–150, *reh'g en banc denied*, 65 Fed. Appx. 511 (5th Cir. 2003), the Fifth Circuit held that a change in classification of property under section 168 is not a change in method of accounting under section 446(e) because the change is the functional equivalent of a change in useful life thereby resulting in the change falling under the useful life exception in § 1.446–1(e)(2)(ii)(b). The Eighth Circuit in *O'Shaughnessy v. Commissioner*, 332 F.3d 1125 (8th Cir. 2003), *rev'g in part* 2002–1 U.S.T.C. (CCH) ¶ 50,235 (D. Minn. 2001), adopted the analysis in *Brookshire* and held that a change in classification of property under section 168 falls within the useful life exception and, thus, does not constitute a change in method of accounting under section 446(e).

Further, in *Green Forest Manufacturing Inc. v. Commissioner*, T.C.Memo. 2003–75, the Tax Court extended its reasoning in *Brookshire*. The court held that a change in computing depreciation from the general depreciation system in section 168(a) to the alternative depreciation system in section 168(g) is a change in classification that falls within the useful life exception and, therefore, is not a change in method of accounting.

As a result of these decisions, there is inconsistent treatment of taxpayers with respect to whether a change in computing depreciation under section 168 is a change in method of accounting under section 446(e). These regulations clarify the changes in depreciation or amortization (depreciation) that are (and are not) changes in method of accounting under section 446(e).

Scope

The regulations provide the changes in depreciation for property for which depreciation is determined under section 167, 168, 197, 1400I, 1400L(b), or 1400L(c), or former section 168, of the Code that are (and are not) changes in method of accounting under section 446(e). The regulations also clarify that the rules in § 1.167(e)–1 with respect to a change in the depreciation method made without the consent of the Commissioner apply only to property for which depreciation is determined under section 167 (other than under section 168, section 1400I, section 1400L, or former section 168).

Changes in Depreciation That Are Changes in Method of Accounting

In general, the regulations provide that a change in the depreciation method, period of recovery, or convention of a depreciable or amortizable asset is a change in method of accounting. This change may be the result of, for example, a change in the classification of property under section 168(e) or a change in computing depreciation from the general depreciation system under section 168(a) to the alternative depreciation system of section 168(g). Further, a change to or from claiming the additional first year depreciation deduction provided by section 168(k) or 1400L(b) is a change in method of accounting under certain circumstances.

The regulations clarify that the useful life exception, which has been moved from § 1.446–1(e)(2)(ii)(b) to § 1.446–1T(e)(2)(ii)(d), applies only to property for which the depreciation is determined under section 167 (other than under section 168, section 1400I, section 1400L, or former section 168). However, a change to or from a useful life (or recovery period or amortization period) that is specifically assigned by the Code, the regulations under the Code, or other guidance published in the Internal Revenue Bulletin is a change in method of accounting.

The regulations also provide that a change in salvage value to zero for a depreciable or amortizable asset for which the salvage value is expressly treated as zero by the Code, the regulations under the Code, or other guidance published in the Internal Revenue Bulletin, is treated as a change in method of accounting. Any other change in salvage value is not treated as a change in method of accounting.

Further, the regulations provide that a change in the accounting for depreciable or amortizable assets from single asset accounting to multiple asset accounting

(pooling), or vice versa, or from one type of multiple asset accounting (pooling) to a different type of multiple asset accounting (pooling) is a change in method of accounting. Also, for depreciable or amortizable assets that are mass assets accounted for in multiple asset accounts or pools, a change in the method of identifying which assets have been disposed is a change in method of accounting (for example, from specific identification to a first-in, first-out method).

Finally, the regulations provide that a change in the treatment of an asset from nondepreciable or nonamortizable (nondepreciable) to depreciable or amortizable (depreciable), or vice versa, is a change in method of accounting. For example, a change in the treatment of an asset that was used entirely in the taxpayer's trade or business and was never held for sale from being treated as inventory to being treated as depreciable property is a change in method of accounting.

Exceptions

The regulations provide that a change in computing depreciation allowances in the taxable year in which the use of property changes in the hands of the same taxpayer is not a change in method of accounting.

The regulations also provide that the making of a late depreciation election or the revocation of a timely valid depreciation election generally is not a change in method of accounting. This rule also applies to the making of a late election or the revocation of a timely valid election under section 13261(g)(2) or (3) of the Revenue Reconciliation Act of 1993 (107 Stat. 312, 540) (relating to amortizable section 197 intangibles). To make a late depreciation election or to revoke a timely valid depreciation election, a taxpayer must submit a request for a private letter ruling. Elections made under section 168(b)(2)(C), 168(b)(3)(D), or 168(g)(7) are irrevocable.

Finally, the regulations provide that any change in the placed-in-service date of a depreciable or amortizable asset is not treated as a change in method of accounting.

Item Being Changed

The regulations clarify that for purposes of changes in depreciation, the item being changed is the depreciation treatment of each individual depreciable or amortizable asset. However, the item is the depreciation treatment of each vintage account with respect to depreciable assets for which depreciation is determined under § 1.167(a)–11 (CLADR property).