



Treasury Decisions
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Rules and Regulations

DEPARTMENT OF THE TREASURY
Internal Revenue Service (IRS)

26 CFR Parts 1 and 602

59 FR 51369; RIN 1545-AN82

General Asset Accounts Under the Accelerated Cost Recovery System

T.D. 8566

DATE: October 11, 1994

ACTION: Final regulations.

SUMMARY: This document contains final regulations on the election to maintain general asset accounts for depreciable assets to which section 168 of the Internal Revenue Code applies. These regulations reflect changes to the law made by the Tax Reform Act of 1986. The regulations will simplify certain depreciation calculations.

EFFECTIVE DATE: October 11, 1994.

For dates of applicability of these regulations, see *Dates* under **SUPPLEMENTARY INFORMATION**.

FOR FURTHER INFORMATION CONTACT: Kathleen Reed at (202) 622-3110 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Paperwork Reduction Act

The collection of information contained in these final regulations has been reviewed and approved by the Office of Management and Budget in accordance with the requirements of the Paperwork Reduction Act (*44 U.S.C 3504(h)*) under control number 1545-1331. The estimated annual burden per respondent or recordkeeper varies from .20 to .30 hours, depending on individual circumstances, with an estimated average of .25 hours.

Comments concerning the accuracy of this burden estimate and suggestions for reducing this burden should be sent to the Internal Revenue Service, Attn: IRS Reports Clearance Officer, PC:FP, Washington, DC 20224, and to the Office of Management and Budget, Attn: Desk Officer for the Department of the Treasury, Office of Information and

Regulatory Affairs, Washington, DC 20503.

Background

On August 31, 1992, the IRS published a notice of proposed rulemaking in the **Federal Register** (57 FR 39374 [PS-55-89, 1992-2 C.B. 870]) proposing amendments to the Income Tax Regulations (26 CFR part 1) under section 168(i)(4). These amendments were proposed to reflect the amendments made by section 201 of the Tax Reform Act of 1986. The preamble to the notice contains an explanation of the proposed regulations.

Written comments responding to the notice were received, and a public hearing was held on November 4, 1992. After considering all written and oral comments, the proposed regulations under section 168(i)(4) are adopted as revised by this Treasury decision.

Explanation of Provisions

In General

The final regulations would simplify the computation of depreciation by allowing taxpayers an election to group assets into one or more general asset accounts under section 168(i)(4). The assets in any particular general asset account are depreciated as a single asset. Unlike the rules under section 168 as in existence before enactment of the Tax Reform Act of 1986, general asset account treatment is not limited to "mass assets."

As required by section 168(i)(4), the final regulations provide generally that the amount realized upon the disposition of an asset from a general asset account is recognized as ordinary income. In addition, special rules are provided for terminating general asset account treatment upon certain dispositions. For transactions described in section 168(i)(7)(B), the transferee generally is bound by the transferor's general asset account election.

Changes to the Proposed Regulations

This Treasury decision generally adopts the rules in the proposed regulations. Certain changes to the proposed regulations have been made, however, in response to comments. These changes and the comments that were not adopted in the final regulations are discussed below.

Assets Subject to Recapture. One commentator recommended that the proposed regulations be amended to allow general asset account treatment for assets qualifying for the credit under section 47 or 48. After considering this comment, the IRS and Treasury Department have concluded that it is appropriate to allow taxpayers greater flexibility in determining what assets will be included in a general asset account. Therefore, the proposed rule that prohibits general asset account treatment for investment credit property has been deleted. Accordingly, under the final regulations, a general asset account may include any depreciable asset for which a credit or deduction is allowable.

A new rule, however, has been added in the final regulations to account for any basis increase upon recapture. The final regulations provide that upon recapture, the asset is removed from the general asset account as of the first day of the taxable year in which the recapture event occurs. In addition, corresponding adjustments to the unadjusted depreciable basis and depreciation reserve of the account must be made. This rule was formulated in view of the limited types of property currently eligible for the investment credit. The IRS, however, may consider other alternatives to take into account the basis increase upon recapture if the scope of property that qualifies for the investment credit is expanded.

Assets Used in a Personal Activity. The final regulations retain the rule of the proposed regulations that a general asset account may not include an asset if a taxpayer uses the asset both in a trade or business (or for the production of income) and in a personal activity at any time during the taxable year in which the asset is first placed in service by the

taxpayer. Consistent with the retention of this rule in the final regulations, a new rule has been added providing that an asset in a general asset account becomes ineligible for general asset account treatment if a taxpayer uses the asset in a personal activity in a taxable year after the taxable year the asset is placed in service. If this change in use occurs, the final regulations provide that the taxpayer must use the method provided in § 1.168(i)-1(e)(3)(iii)(C) for adjusting a general asset account when an asset becomes ineligible for general asset account treatment.

Assets that Generate Foreign Source Income. A commentator suggested that the proposed regulations be amended to allow general asset account treatment for assets generating foreign source income.

In response to this comment, the final regulations allow general asset account treatment for assets generating foreign source income. If, however, the inclusion of these assets in a general asset account results in a substantial distortion of income, the Commissioner may disregard the general asset account election and make reallocations of income or expense as necessary to clearly reflect income.

The final regulations provide a rule coordinating the general asset account rules with the rules in § 1.8611-9T(g)(3) relating to allocation and apportionment of interest expense under the asset method. A general asset account will be treated as a single asset for purposes of applying the rules in § 1.861-9T(g)(3). If the general asset account generates income in more than one separate grouping (statutory and residual), then the account is a multiple category asset, as defined in § 1.861-9T(g)(3)(ii), and the income yield from the general asset account must be computed as if the account were a single multiple category asset.

The final regulations also provide rules for determining the source of income from a disposition of an asset in a general asset account. If the general asset account includes assets generating both United States and foreign source income, any amount of ordinary income, gain, or loss recognized on the disposition must be apportioned between United States and foreign sources based on the allocation and apportionment of depreciation allowed for the general asset account or for the disposed asset, as applicable. If the general asset account includes assets that generate foreign source income in more than one separate category under section 904(d)(1) or another section of the Internal Revenue Code, or under a United States income tax treaty that requires the foreign tax credit limitation to be determined separately for specified types of income, then the amount of ordinary income, gain, or loss recognized on the disposition that is treated as foreign source income must be allocated and apportioned to the applicable separate category or categories.

Disposition of All Assets or the Last Asset. One commentator questioned whether the rule under the proposed regulations that provided that a general asset account terminates on the disposition of all of the assets in the account or the last asset in the account was mandatory. In response to this comment, the final regulations clarify that this rule is an optional rule for taxpayers that maintain records showing the disposition of assets in a general asset account. The final regulations also provide that a taxpayer adopts the rule by reporting the gain or loss on the taxpayer's income tax return for the taxable year in which the disposition of all of the assets, or the last asset, in the general asset account occurs.

Qualifying Dispositions. Under the proposed regulations, a qualifying disposition of an asset in a general asset account occurs when the asset is disposed of as a direct result of a cessation, termination, curtailment, or disposition of a business, manufacturing or other income producing process, operation, facility, plant, or other unit (other than by transfer to a supplies, scrap, or similar account). One commentator recommended that the final regulations should provide an example showing that the sale of an undivided interest in mineral property, along with the related operating equipment, is a curtailment of a taxpayer's business and, thus, constitutes a qualifying disposition. A curtailment was intended to be limited to a genuine business contraction and not to include transactions involving the sale of an undivided interest, other than the taxpayer's entire interest in assets. To avoid any further misinterpretation, the final regulations delete the term "curtailment." The final regulations also clarify that a taxpayer adopts the rule to terminate general asset account treatment for an asset in a qualifying disposition by reporting the gain, loss, or other deduction on the taxpayer's income tax return for the taxable year in which the qualifying disposition occurs.

Anti-abuse rule. The final regulations add examples of transactions subject to the anti-abuse rule.

Election. Some commentators noted that the proposed regulations do not address whether the election is made by the common parent corporation or each member of an affiliated group, by a partnership or its partners, or by an S corporation or the S corporation shareholders. The final regulations clarify that the election is made by each member of an affiliated group, by the partnership, or by the S corporation, respectively.

The proposed regulations provide that the election to apply the regulations generally is binding on the taxpayer for computing taxable income as well as computing alternative minimum taxable income. A commentator suggested that the final regulations should allow taxpayers the option to make the election for either the regular income tax, the alternative minimum tax, or both. This rule was not adopted because of the separate and parallel nature of the regular tax and alternative minimum tax systems. Except as otherwise provided by statute or regulations, all Code provisions that apply in determining the regular taxable income of a taxpayer also apply in determining the alternative minimum taxable income of the taxpayer. The final regulations have not been expanded to include any exceptions. Consequently, an election to apply section 168(i)(4) for determining regular taxable income also applies for determining alternative minimum taxable income. Therefore, the language "as well as alternative minimum taxable income" in the proposed rule is redundant and has been deleted from the final regulations.

Effective Date. For assets placed in service after December 31, 1986, in taxable years ending before the effective date of the final regulations, one commentator recommended that the final regulations should provide a retroactive election or, alternatively, a prospective election. Another commentator also requested a provision allowing a prospective election. The final regulations retain the rule of the proposed regulations that, for prior periods, a taxpayer may use any reasonable method that is consistently applied to the taxpayer's general asset accounts.

Dates

The final regulations are effective for property placed in service in taxable years ending on or after October 11, 1994. For property placed in service after December 31, 1986, in taxable years ending before October 11, 1994, the IRS will allow any reasonable method that is consistently applied to the taxpayer's general asset accounts.

Special Analyses

It has been determined that this Treasury decision is not a significant regulatory action as defined in EO 12866. Therefore, a regulatory assessment is not required. It also has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) and the Regulatory Flexibility Act (5 U.S.C. chapter 6) do not apply to these regulations, and, therefore, a Regulatory Flexibility Analysis is not required. Pursuant to section 7805(f) of the Internal Revenue Code, the notice of proposed rulemaking preceding these regulations was submitted to the Small Business Administration for comment on its impact on small business.

Drafting Information

The principal author of these regulations is Kathleen Reed, Office of Assistant Chief Counsel (Passthroughs and Special Industries), IRS. However, other personnel from the IRS and Treasury Department participated in their development.

List of Subjects

26 CFR Part 1

Income taxes, Reporting and recordkeeping requirements.

26 CFR Part 602

Reporting and recordkeeping requirements.

Adoption of Amendments to the Regulations

Accordingly, 26 CFR parts 1 and 602 are amended as follows:

PART 1-INCOME TAXES

Paragraph 1. The authority citation for part 1 is amended by adding an entry in numerical order to read as follows:

Authority: 26 U.S.C. 7805 * * *

Section 1.168(i)-1 also issued under 26 U.S.C. 168(i)(4). * * *

Par. 2. Section 1.56(g)-1 is amended by adding a sentence at the end of paragraph (b), introductory text, to read as follows:

§ 1.56(g)-1 -- Adjusted current earnings.

* * * * *

(b) * * * See § 1.168(i)-1(k) for an election to use general asset accounts.

* * * * *

Par. 3. Sections 1.168(i)-0 and 1.168(i)-1 are added to read as follows:

§ 1.168(i)-0 -- Table of contents for the general asset account rules.

This section lists the major paragraphs contained in § 1.168(i)-1.

§ 1.168(i)-1 -- General asset accounts.

(a) *Scope.*

(b) *Definitions.*

- (1) Unadjusted depreciable basis.
- (2) Unadjusted depreciable basis of the general asset account.
- (3) Adjusted depreciable basis of the general asset account.
- (4) Expensed cost.

(c) *Establishment of general asset accounts.*

- (1) Assets eligible for general asset accounts.

- (i) General rules.
- (ii) Special rules for assets generating foreign source income.
- (2) Grouping assets in general asset accounts.
 - (i) General rules.
 - (ii) Special rules.
- (d) *Determination of depreciation allowance.*
 - (1) In general.
 - (2) Special rule for passenger automobiles.
- (e) *Disposition of an asset from a general asset account.*
 - (1) Scope.
 - (2) General rules for a disposition.
 - (i) No immediate recovery of basis.
 - (ii) Treatment of amount realized.
 - (iii) Effect of disposition on a general asset account.
 - (iv) Coordination with nonrecognition provisions.
 - (v) Examples.
 - (3) Special rules.
 - (i) In general.
 - (ii) Disposition of all assets remaining in a general asset account.
 - (iii) Disposition of an asset in a qualifying disposition.
 - (iv) Transactions subject to section 168(i)(7).
 - (v) Anti-abuse rule.
- (f) *Assets generating foreign source income.*
 - (1) In general.
 - (2) Source of ordinary income, gain, or loss.
 - (i) Source determined by allocation and apportionment of depreciation allowed.
 - (ii) Formula for determining foreign source income, gain, or loss.
 - (3) Section 904(d) separate categories.

(g) *Assets subject to recapture.*

(h) *Changes in use.*

(1) Conversion to personal use.

(2) Other changes in use.

(i) *Identification of disposed or converted asset.*

(j) *Effect of adjustments on prior dispositions.*

(k) *Election.*

(1) Irrevocable election.

(2) Time for making election.

(3) Manner of making election.

(l) *Effective date.*

§ 1.168(i)-1 -- General asset accounts.

(a) *Scope.* This section provides rules for general asset accounts under section 168(i)(4). The provisions of this section apply only to assets for which an election has been made under paragraph (k) of this section.

(b) *Definitions.* For purposes of this section, the following definitions apply:

(1) *Unadjusted depreciable basis* is the basis of an asset for purposes of section 1011 without regard to any adjustments described in sections 1016(a)(2) and (3).

(2) *Unadjusted depreciable basis of the general asset account* is the sum of the unadjusted depreciable bases of all assets included in the general asset account.

(3) *Adjusted depreciable basis of the general asset account* is the unadjusted depreciable basis of the general asset account less the adjustments to basis described in sections 1016(a)(2) and (3).

(4) *Expensed cost* is the amount of any allowable credit or deduction treated as a deduction allowable for depreciation or amortization for purposes of section 1245 (for example, a credit allowable under section 30 or a deduction allowable under section 179, 179A, or 190).

(c) *Establishment of general asset accounts-*(1) *Assets eligible for general asset accounts-*(i) *General rules.* Assets that are subject to either the general depreciation system of section 168(a) or the alternative depreciation system of section 168(g) may be accounted for in one or more general asset accounts. An asset may be included in a general asset account only to the extent of the asset's unadjusted depreciable basis (for example, if, in 1995, a taxpayer places in service an asset that costs \$ 20,000 and elects under section 179 to expense \$ 17,500 of that asset's cost, the unadjusted depreciable basis of the asset is \$ 2,500 and, therefore, only \$ 2,500 of the asset's cost may be included in a general asset account). However, an asset is not to be included in a general asset account if the asset is used both in a trade or business (or for the production of income) and in a personal activity at any time during the taxable year in which the asset is first placed in service by the taxpayer.

(ii) *Special rules for assets generating foreign source income*-(A) Assets that generate foreign source income, both United States and foreign source income, or combined gross income of a FSC (as defined in section 922), DISC (as defined in section 992(a)), or possessions corporation (as defined in section 936) and its related supplier, may be included in a general asset account if the requirements of paragraph (c)(2)(i) of this section are satisfied. If, however, the inclusion of these assets in a general asset account results in a substantial distortion of income, the Commissioner may disregard the general asset account election and make any reallocations of income or expense necessary to clearly reflect income.

(B) A general asset account shall be treated as a single asset for purposes of applying the rules in § 1.861-9T(g)(3) (relating to allocation and apportionment of interest expense under the asset method). A general asset account that generates income in more than one grouping of income (statutory and residual) is a multiple category asset (as defined in § 1.861-9T(g)(3)(ii)), and the income yield from the general asset account must be determined by applying the rules for multiple category assets as if the general asset account were a single asset.

(2) *Grouping assets in general asset accounts*-(i) *General rules*. If a taxpayer makes the election under paragraph (k) of this section, assets that are subject to the election are grouped into one or more general asset accounts. Assets that are eligible to be grouped into a single general asset account may be divided into more than one general asset account. Each general asset account must include only assets that-

(A) Have the same asset class (for further guidance, see *Rev. Proc. 87-56, 1987-2 C.B. 674*, and § 601.601(d)(2)(ii)(b) of this chapter);

(B) Have the same applicable depreciation method;

(C) Have the same applicable recovery period;

(D) Have the same applicable convention; and

(E) Are placed in service by the taxpayer in the same taxable year.

(ii) *Special rules*. In addition to the general rules in paragraph (c)(2)(i) of this section, the following rules apply when establishing general asset accounts-

(A) Assets without an asset class, but with the same characteristics described in paragraphs (c)(2)(i)(B), (C), (D), and (E) of this section, may be grouped into a general asset account;

(B) Assets subject to the mid-quarter convention may only be grouped into a general asset account with assets that are placed in service in the same quarter of the taxable year;

(C) Assets subject to the mid-month convention may only be grouped into a general asset account with assets that are placed in service in the same month of the taxable year; and

(D) Passenger automobiles for which the depreciation allowance is limited under section 280F(a) must be grouped into a separate general asset account.

(d) *Determination of depreciation allowance*-(1) *In general*. Depreciation allowances are determined for each general asset account by using the applicable depreciation method, recovery period, and convention for the assets in the account. The depreciation allowances are recorded in a depreciation reserve account for each general asset account. The allowance for depreciation under this section constitutes the amount of depreciation allowable under section 167(a).

(2) *Special rule for passenger automobiles*. For purposes of applying section 280F(a), the depreciation allowance for a general asset account established for passenger automobiles is limited for each taxable year to the amount prescribed in section 280F(a) multiplied by the excess of the number of automobiles originally included in the account

over the number of automobiles disposed of during the taxable year or in any prior taxable year in a transaction described in paragraph (e)(3)(iii) (disposition of an asset in a qualifying disposition), (e)(3)(iv) (transactions subject to section 168(i)(7)), (e)(3)(v) (anti-abuse rule), (g) (assets subject to recapture), or (h)(1) (conversion to personal use) of this section.

(e) *Disposition of an asset from a general asset account*-(1) *Scope*. This paragraph (e) provides rules applicable to dispositions of assets included in a general asset account. For purposes of this paragraph (e), an asset in a general asset account is disposed of when ownership of the asset is transferred or when the asset is permanently withdrawn from use either in the taxpayer's trade or business or in the production of income. A disposition includes the sale, exchange, retirement, physical abandonment, or destruction of an asset. A disposition also occurs when an asset is transferred to a supplies, scrap, or similar account. A disposition does not include, however, the retirement of a structural component of real property.

(2) *General rules for a disposition*-(i) *No immediate recovery of basis*. Immediately before a disposition of any asset in a general asset account, the asset is treated as having an adjusted basis of zero for purposes of section 1011. Therefore, no loss is realized upon the disposition of an asset from the general asset account. Similarly, where an asset is disposed of by transfer to a supplies, scrap, or similar account, the basis of the asset in the supplies, scrap, or similar account will be zero.

(ii) *Treatment of amount realized*. Any amount realized on a disposition is recognized as ordinary income (notwithstanding any other provision of subtitle A of the Internal Revenue Code (Code)) to the extent the sum of the unadjusted depreciable basis of the general asset account and any expensed cost (as defined in paragraph (b)(4) of this section) for assets in the account exceeds any amounts previously recognized as ordinary income upon the disposition of other assets in the account. The recognition and character of any excess amount realized are determined under other applicable provisions of the Code (other than sections 1245 and 1250 or provisions of the Code that treat gain on a disposition as subject to section 1245 or 1250).

(iii) *Effect of disposition on a general asset account*. The unadjusted depreciable basis and the depreciation reserve of the general asset account are not affected as a result of a disposition of an asset from the general asset account.

(iv) *Coordination with nonrecognition provisions*. For purposes of determining the basis of an asset acquired in a transaction described in paragraph (e)(3)(iii)(B)(4) of this section (relating to certain nonrecognition provisions), the amount of ordinary income recognized under this paragraph (e)(2) is treated as the amount of gain recognized on the disposition.

(v) *Examples*. The following examples illustrate the application of this paragraph (e)(2).

Example 1. (i) *R*, a calendar-year corporation, maintains one general asset account for ten machines. The machines cost a total of \$ 10,000 and were placed in service in June 1995. Of the ten machines, one machine costs \$ 8,200 and nine machines cost a total of \$ 1,800. Assume this general asset account has a depreciation method of 200 percent declining balance, a recovery period of 5 years, and a half-year convention. *R* does not make a section 179 election for any of the machines. As of January 1, 1996, the depreciation reserve of the account is \$ 2,000 $[(\$ 10,000 - \$ 0) \times 40\% / 2]$.

(ii) On February 8, 1996, *R* sells the machine that cost \$ 8,200 to an unrelated party for \$ 9,000. Under paragraph (e)(2)(i) of this section, this machine has an adjusted basis of zero.

(iii) On its 1996 tax return, *R* recognizes the amount realized of \$ 9,000 as ordinary income because such amount does not exceed the unadjusted depreciable basis of the general asset account (\$ 10,000), plus any expensed cost for assets in the account (\$ 0), less amounts previously recognized as ordinary income (\$ 0). Moreover, the unadjusted depreciable basis and depreciation reserve of the account are not affected by the disposition of the machine. Thus, the depreciation allowance for the account in 1996 is \$ 3,200 $(\$ 10,000 - \$ 2,000) \times 40\%$.

Example 2. (i) The facts are the same as in *Example 1*. In addition, on June 4, 1997, *R* sells seven machines to an unrelated party for a total of \$ 1,100. In accordance with paragraph (e)(2)(i) of this section, these machines have an adjusted basis of zero.

(ii) On its 1997 tax return, *R* recognizes \$ 1,000 as ordinary income (the unadjusted depreciable basis of \$ 10,000, plus the expensed cost of \$ 0, less the amount of \$ 9,000 previously recognized as ordinary income). The recognition and character of the excess amount realized of \$ 100 (\$ 1,100-\$ 1,000) are determined under applicable provisions of the Code other than section 1245 (such as section 1231). Moreover, the unadjusted depreciable basis and depreciation reserve of the account are not affected by the disposition of the machines. Thus, the depreciation allowance for the account in 1997 is \$ 1,920 (($\$ 10,000 - \$ 5,200$) $\times 40\%$).

(3) *Special rules*-(i) *In general*. This paragraph (e)(3) provides the rules for terminating general asset account treatment upon certain dispositions. While the rules under paragraphs (e)(3)(ii) and (iii) of this section are optional rules, the rules under paragraphs (e)(3)(iv) and (v) of this section are mandatory rules. A taxpayer applies paragraph (e)(3)(ii) or (iii) of this section by reporting the gain, loss, or other deduction on the taxpayer's timely filed (including extensions) income tax return for the taxable year in which the disposition occurs. For purposes of applying paragraph (e)(3)(iii) through (v) of this section, see paragraph (i) of this section for identifying the unadjusted depreciable basis of a disposed asset.

(ii) *Disposition of all assets remaining in a general asset account*-(A) *Optional termination of a general asset account*. Upon the disposition of all of the assets, or the last asset, in a general asset account, a taxpayer may apply this paragraph (e)(3)(ii) to recover the adjusted depreciable basis of the general asset account (rather than having paragraph (e)(2) of this section apply). Under this paragraph (e)(3)(ii), the general asset account terminates and the amount of gain or loss for the general asset account is determined under section 1001(a) by taking into account the adjusted depreciable basis of the general asset account at the time of the disposition. The recognition and character of the gain or loss are determined under other applicable provisions of the Code, except that the amount of gain subject to section 1245 (or section 1250) is limited to the excess of the depreciation allowed or allowable for the general asset account, including any expensed cost (or the excess of the additional depreciation allowed or allowable for the general asset account), over any amounts previously recognized as ordinary income under paragraph (e)(2) of this section.

(B) *Example*. The following example illustrates the application of this paragraph (e)(3)(ii).

Example. (i) *T*, a calendar-year corporation, maintains a general asset account for 1,000 calculators. The calculators cost a total of \$ 60,000 and were placed in service in 1995. Assume this general asset account has a depreciation method of 200 percent declining balance, a recovery period of 5 years, and a half-year convention. *T* does not make a section 179 election for any of the calculators. In 1996, *T* sells 200 of the calculators to an unrelated party for a total of \$ 10,000 and recognizes the \$ 10,000 as ordinary income in accordance with paragraph (e)(2) of this section.

(ii) On March 26, 1997, *T* sells the remaining calculators in the general asset account to an unrelated party for \$ 35,000. *T* chooses to apply paragraph (e)(3)(ii) of this section. As a result, the account terminates and gain or loss is determined for the account.

(iii) On the date of disposition, the adjusted depreciable basis of the account is \$ 23,040 (unadjusted depreciable basis of \$ 60,000 less the depreciation allowed or allowable of \$ 36,960). Thus, in 1997, *T* recognizes gain of \$ 11,960 (amount realized of \$ 35,000 less the adjusted depreciable basis of \$ 23,040). The gain of \$ 11,960 is subject to section 1245 to the extent of the depreciation allowed or allowable for the account (plus the expensed cost for assets in the account) less the amounts previously recognized as ordinary income ($\$ 36,960 + \$ 0 - \$ 10,000 = \$ 26,960$). As a result, the entire gain of \$ 11,960 is subject to section 1245.

(iii) *Disposition of an asset in a qualifying disposition*-(A) *Optional determination of the amount of gain, loss, or*

other deduction. In the case of a qualifying disposition of an asset (described in paragraph (e)(3)(iii)(B) of this section), a taxpayer may apply this paragraph (e)(3)(iii) (rather than having paragraph (e)(2) of this section apply). Under this paragraph (e)(3)(iii), general asset account treatment for the asset terminates as of the first day of the taxable year in which the qualifying disposition occurs, and the amount of gain, loss, or other deduction for the asset is determined by taking into account the asset's adjusted basis. The adjusted basis of the asset at the time of the disposition equals the unadjusted depreciable basis of the asset less the depreciation allowed or allowable for the asset, computed by using the depreciation method, recovery period, and convention applicable to the general asset account in which the asset was included. The recognition and character of the gain, loss, or other deduction are determined under other applicable provisions of the Code, except that the amount of gain subject to section 1245 (or section 1250) is limited to the lesser of-

(1) The depreciation allowed or allowable for the asset, including any expensed cost (or the additional depreciation allowed or allowable for the asset); or

(2) The excess of-

(i) The original unadjusted depreciable basis of the general asset account plus, in the case of section 1245 property originally included in the general asset account, any expensed cost; over

(ii) The cumulative amounts of gain previously recognized as ordinary income under either paragraph (e)(2) of this section or section 1245 (or section 1250).

(B) *Qualifying dispositions.* A qualifying disposition is a disposition that does not involve all the assets, or the last asset, remaining in a general asset account and that is-

(1) A direct result of a fire, storm, shipwreck, or other casualty, or from theft;

(2) A charitable contribution for which a deduction is allowable under section 170;

(3) A direct result of a cessation, termination, or disposition of a business, manufacturing or other income producing process, operation, facility, plant, or other unit (other than by transfer to a supplies, scrap, or similar account); or

(4) A transaction, other than a transaction described in paragraph (e)(3)(iv) of this section (pertaining to transactions subject to section 168(i)(7)), to which a nonrecognition section of the Code applies (determined without regard to this section), such as section 1031 or 1033.

(C) *Effect of a qualifying disposition on a general asset account.* If the taxpayer applies this paragraph (e)(3)(iii) to a qualifying disposition of an asset, then-

(1) The asset is removed from the general asset account as of the first day of the taxable year in which the qualifying disposition occurs;

(2) The unadjusted depreciable basis of the general asset account is reduced by the unadjusted depreciable basis of the asset as of the first day of the taxable year in which the disposition occurs;

(3) The depreciation reserve of the general asset account is reduced by the depreciation allowed or allowable for the asset as of the end of the taxable year immediately preceding the year of disposition, computed by using the depreciation method, recovery period, and convention applicable to the general asset account in which the asset was included; and

(4) For purposes of determining the amount of gain realized on subsequent dispositions that is subject to ordinary income treatment under paragraph (e)(2)(ii) of this section, the amount of any expensed cost with respect to the asset is

disregarded.

(D) *Example.* The provisions of this paragraph (e)(3)(iii) are illustrated by the following example.

Example. (i) Z, a calendar-year corporation, maintains one general asset account for 12 machines. Each machine costs \$ 15,000 and was placed in service in 1995. Of the 12 machines, nine machines that cost a total of \$ 135,000 are used in Z's Kentucky plant, and three machines that cost a total of \$ 45,000 are used in Z's Ohio plant. Assume this general asset account has a depreciation method of 200 percent declining balance, a recovery period of 5 years, and a half-year convention. Z does not make a section 179 election for any of the machines. As of January 1, 1997, the depreciation reserve for the account is \$ 93,600.

(ii) On May 27, 1997, Z sells its entire manufacturing plant in Ohio to an unrelated party. The sales proceeds allocated to each of the three machines at the Ohio plant is \$ 5,000. Because this transaction is a qualifying disposition under paragraph (e)(3)(iii)(B)(3) of this section, Z chooses to apply paragraph (e)(3)(iii) of this section.

(iii) For Z's 1997 return, the depreciation allowance for the account is computed as follows. As of December 31, 1996, the depreciation allowed or allowable for the three machines at the Ohio plant is \$ 23,400. Thus, as of January 1, 1997, the unadjusted depreciable basis of the account is reduced from \$ 180,000 to \$ 135,000 (\$ 180,000 less the unadjusted depreciable basis of \$ 45,000 for the three machines), and the depreciation reserve of the account is decreased from \$ 93,600 to \$ 70,200 (\$ 93,600 less the depreciation allowed or allowable of \$ 23,400 for the three machines as of December 31, 1996). Consequently, the depreciation allowance for the account in 1997 is \$ 25,920 (($\$ 135,000 - \$ 70,200$) x 40%).

(iv) For Z's 1997 return, gain or loss for each of the three machines at the Ohio plant is determined as follows. The depreciation allowed or allowable in 1997 for each machine is \$ 1,440 [$(\$ 15,000 - \$ 7,800) \times 40\% / 2$]. Thus, the adjusted basis of each machine under section 1011 is \$ 5,760 (the adjusted depreciable basis of \$ 7,200 removed from the account less the depreciation allowed or allowable of \$ 1,440 in 1997). As a result, the loss recognized in 1997 for each machine is \$ 760 ($\$ 5,000 - \$ 5,760$), which is subject to section 1231.

(iv) *Transactions subject to section 168(i)(7).* If an asset in a general asset account is transferred in a transaction described in section 168(i)(7)(B) (pertaining to treatment of transferees in certain nonrecognition transactions), the transferor must remove the transferred asset from the general asset account as of the first day of the taxable year in which the transaction occurs. In addition, the adjustments to the general asset account described in paragraph (e)(3)(iii)(C)(2) through (4) of this section must be made. The transferee is bound by the transferor's election under paragraph (k) of this section with respect to so much of the asset's basis in the hands of the transferee as does not exceed the asset's adjusted basis in the hands of the transferor. If all of the assets, or the last asset, in a general asset account are transferred, the transferee's basis in the assets or asset transferred is equal to the adjusted depreciable basis of the general asset account as of the beginning of the transferor's taxable year in which the transaction occurs, decreased by the amount of depreciation allocable to the transferor for the year of the transfer.

(v) *Anti-abuse rule-(A) In general.* If an asset in a general asset account is disposed of by a taxpayer in a transaction described in paragraph (e)(3)(v)(B) of this section, general asset account treatment for the asset terminates as of the first day of the taxable year in which the disposition occurs. Consequently, the taxpayer must determine the amount of gain, loss, or other deduction attributable to the disposition in the manner described in paragraph (e)(3)(iii)(A) of this section (notwithstanding that paragraph (e)(3)(iii)(A) of this section is an optional rule) and must make the adjustments to the general asset account described in paragraph (e)(3)(iii)(C)(1) through (4) of this section.

(B) *Abusive transactions.* A transaction is described in this paragraph (e)(3)(v)(B) if the transaction is not described in paragraph (e)(3)(iv) of this section and the transaction is entered into, or made, with a principal purpose of achieving a tax benefit or result that would not be available absent an election under this section. Examples of these types of transactions include-

(1) A transaction entered into with a principal purpose of shifting income or deductions among taxpayers in a manner that would not be possible absent an election under this section in order to take advantage of differing effective tax rates among the taxpayers; or

(2) An election made under this section with a principal purpose of disposing of an asset from a general asset account in order to utilize an expiring net operating loss or credit. The fact that a taxpayer with a net operating loss carryover or a credit carryover transfers an asset to a related person or transfers an asset pursuant to an arrangement where the asset continues to be used (or is available for use) by the taxpayer pursuant to a lease (or otherwise) indicates, absent strong evidence to the contrary, that the transaction is described in this paragraph (e)(3)(v)(B).

(f) *Assets generating foreign source income*-(1) *In general*. This paragraph (f) provides the rules for determining the source of any income, gain, or loss recognized, and the appropriate section 904(d) separate limitation category or categories for any foreign source income, gain, or loss recognized, on a disposition (within the meaning of paragraph (e)(1) of this section) of an asset in a general asset account that consists of assets generating both United States and foreign source income. These rules apply only to a disposition to which paragraph (e)(2) (general disposition rules), (e)(3)(ii) (disposition of all assets remaining in a general asset account), (e)(3)(iii) (disposition of an asset in a qualifying disposition), or (e)(3)(v) (anti-abuse rule) of this section applies.

(2) *Source of ordinary income, gain, or loss*-(i) *Source determined by allocation and apportionment of depreciation allowed*. The amount of any ordinary income, gain, or loss that is recognized on the disposition of an asset in a general asset account must be apportioned between United States and foreign sources based on the allocation and apportionment of the-

(A) Depreciation allowed for the general asset account as of the end of the taxable year in which the disposition occurs if paragraph (e)(2) of this section applies to the disposition;

(B) Depreciation allowed for the general asset account as of the time of the disposition if the taxpayer applies paragraph (e)(3)(ii) of this section to the disposition of all of the assets, or the last asset, in the general asset account; or

(C) Depreciation allowed for the disposed asset for only the taxable year in which the disposition occurs if the taxpayer applies paragraph (e)(3)(iii) to the disposition of the asset in a qualifying disposition or if the asset is disposed in a transaction described in paragraph (e)(3)(v) (anti-abuse rule) of this section.

(ii) *Formula for determining foreign source income, gain, or loss*. The amount of ordinary income, gain, or loss recognized on the disposition that shall be treated as foreign source income, gain, or loss must be determined under the formula in this paragraph (f)(2)(ii). For purposes of this formula, the allowed depreciation deductions are determined for the applicable time period provided in paragraph (f)(2)(i) of this section. The formula is:

Foreign	=	Total	x	Allowed
Source		Ordinary		Depreciation
Income, Gain,		Income,		Deductions
or Loss from		Gain, or		Allocated and
the		Loss from		Apportioned to
Disposition		Disposition		Foreign Source
of an Asset		of an Asset		Income Total
				Allowed
				Depreciation

Deductions for
the General
Asset Account
or for the
Disposed Asset
(as applicable)

(3) *Section 904(d) separate categories.* If the assets in the general asset account generate foreign source income in more than one separate category under section 904(d)(1) or another section of the Code (for example, income treated as foreign source income under section 904(g)(10)), or under a United States income tax treaty that requires the foreign tax credit limitation to be determined separately for specified types of income, the amount of "foreign source income, gain, or loss from the disposition of an asset" (as determined under the formula in paragraph (f)(2)(ii) of this section) must be allocated and apportioned to the applicable separate category or categories under the formula in this paragraph (f)(3). For purposes of this formula, the allowed depreciation deductions are determined for the applicable time period provided in paragraph (f)(2)(i) of this section. The formula is:

Foreign Source Income, Gain, or Loss In a Separate Category	=	Foreign Source Income, Gain, or Loss from the Disposition of an Asset	x	Allowed Depreciation Deductions Allocated and Apportioned to a Separate Category Total Allowed Depreciation Deductions and Apportioned to Foreign Source Income
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(g) *Assets subject to recapture.* If the basis of an asset in a general asset account is increased as a result of the recapture of any allowable credit or deduction (for example, the basis adjustment for the recapture amount under section 30(d)(2), 50(c)(2), 179(d)(10), or 179A(e)(4)), general asset account treatment for the asset terminates as of the first day of the taxable year in which the recapture event occurs. Consequently, the taxpayer must remove the asset from the general asset account as of that day and must make the adjustments to the general asset account described in paragraph (e)(3)(iii)(C)(2) through (4) of this section.

(h) *Changes in use-(1) Conversion to personal use.* An asset in a general asset account becomes ineligible for general asset account treatment if a taxpayer uses the asset in a personal activity during a taxable year. Upon a conversion to personal use, the taxpayer must remove the asset from the general asset account as of the first day of the taxable year in which the change in use occurs and must make the adjustments to the general asset account described in

paragraph (e)(3)(iii)(C)(2) through (4) of this section.

(2) *Other changes in use.* [Reserved].

(i) *Identification of disposed or converted asset.* A taxpayer may use any reasonable method that is consistently applied to the taxpayer's general asset accounts for purposes of determining the unadjusted depreciable basis of a disposed or converted asset in a transaction described in paragraph (e)(3)(iii) (disposition of an asset in a qualifying disposition), (e)(3)(iv) (transactions subject to section 168(i)(7)), (e)(3)(v) (anti-abuse rule), (g) (assets subject to recapture), or (h)(1) (conversion to personal use) of this section.

(j) *Effect of adjustments on prior dispositions.* The adjustments to a general asset account under paragraph (e)(3)(iii), (e)(3)(iv), (e)(3)(v), (g), or (h)(1) of this section have no effect on the recognition and character of prior dispositions subject to paragraph (e)(2) of this section.

(k) *Election-(1) Irrevocable election.* If a taxpayer makes an election under this paragraph (k), the taxpayer consents to, and agrees to apply, all of the provisions of this section to the assets included in a general asset account. Except as provided in paragraph (c)(1)(ii)(A), (e)(3), (g), or (h)(1) of this section, an election made under this section is irrevocable and will be binding on the taxpayer for computing taxable income for the taxable year for which the election is made and for all subsequent taxable years. An election under this paragraph (k) is made separately by each person owning an asset to which this section applies (for example, by each member of a consolidated group, at the partnership level (and not by the partner separately), or at the S corporation level (and not by the shareholder separately)).

(2) *Time for making election.* The election to apply this section shall be made on the taxpayer's timely filed (including extensions) income tax return for the taxable year in which the assets included in the general asset account are placed in service by the taxpayer.

(3) *Manner of making election.* In the year of election, a taxpayer makes the election under this section by typing or legibly printing at the top of the Form 4562, "GENERAL ASSET ACCOUNT ELECTION MADE UNDER SECTION 168(i)(4)," or in the manner provided for on Form 4562 and its instructions. The taxpayer shall maintain records (for example, "General Asset Account # 1 - all 1995 additions in asset class 00.11 for Salt Lake City, Utah facility") that identify the assets included in each general asset account, that establish the unadjusted depreciable basis and depreciation reserve of the general asset account, and that reflect the amount realized during the taxable year upon dispositions from each general asset account. (But see section 179(c) and § 1.179-5 for the recordkeeping requirements for section 179 property.) The taxpayer's recordkeeping practices should be consistently applied to the general asset accounts. If Form 4562 is revised or renumbered, any reference in this section to that form shall be treated as a reference to the revised or renumbered form.

(l) *Effective date.* 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.

PART 602-OMB CONTROL NUMBERS UNDER THE PAPERWORK REDUCTION ACT

Par. 4. The authority citation for part 602 continues to read as follows:

Authority: 26 U.S.C. 7805.

§ 602.101(c) -- [Amended]

Par. 5. Section 602.101(c) is amended by adding the entry "1.168(i)-1....1545-1331" in numerical order to the table.

T.D. 8566

Margaret Milner Richardson,

Commissioner of Internal Revenue.

Approved: September 9, 1994

Leslie Samuels,

Assistant Secretary of the Treasury.

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