4. Figuring Depreciation Under MACRS

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Introduction

The Modified Accelerated Cost Recovery System (MACRS) is used to recover the basis of most business and investment property placed in service after 1986. MACRS consists of two depreciation systems, the General Depreciation System (GDS) and the Alternative Depreciation System (ADS). Generally, these systems provide different methods and recovery periods to use in figuring depreciation deductions.

CAUTION

To be sure you can use MACRS to figure depreciation for your property, see Which Method Can You Use To Depreciate Your Property in
chapter 1.

This chapter explains how to determine which MACRS depreciation system applies to your property. It also discusses other information you need to know before you can figure depreciation under MACRS. This information includes the property's recovery class, placed in service date, and basis, as well as the applicable recovery period, convention, and depreciation method. It explains how to use this information to figure your depreciation deduction and how to use a general asset account to depreciate a group of properties. Finally, it explains when and how to recapture MACRS depreciation.

Useful Items - You may want to see:

Publication

- 225 Farmer's Tax Guide
- 463 Travel, Entertainment, Gift, and Car Expenses
- 544 Sales and Other Dispositions of Assets
- 551 Basis of Assets
- 587 Business Use of Your Home (Including Use by Daycare Providers)

Form (and Instructions)

- 2106 Employee Business Expenses
- 2106-EZ Unreimbursed Employee Business Expenses
- 4562 Depreciation and Amortization

See chapter 6 for information about getting publications and forms.

Which Depreciation System (GDS or ADS) Applies?

Your use of either the General Depreciation System (GDS) or the Alternative Depreciation System (ADS) to depreciate property under MACRS determines what depreciation method and recovery period you use. You generally must use GDS unless you are specifically required by law to use ADS or you elect to use ADS.

If you placed your property in service in 2010, complete Part III of Form 4562 to report depreciation using MACRS. Complete section B of Part III to report depreciation using GDS, and complete section C of Part III to report depreciation using ADS. If you placed your property in service before 2010 and are required to file Form 4562, report depreciation using either GDS or ADS on line 17 in Part III.

Required use of ADS. You must use ADS for the following property.

- Listed property used 50% or less in a qualified business use. See chapter 5 for information on listed property.
- Any tangible property used predominantly outside the United States during the year.
- Any tax-exempt use property.
- Any tax-exempt bond-financed property.
- All property used predominantly in a farming business and placed in service in any tax year during which an election not to apply the uniform capitalization rules to certain farming costs is in effect.
- Any property imported from a foreign country for which an Executive Order is in effect because the country maintains trade restrictions or engages in other discriminatory acts.

CAUTION

If you are required to use ADS to depreciate your property, you cannot claim any special depreciation allowance (discussed in chapter 3) for the property.

Electing ADS. Although your property may qualify for GDS, you can elect to use ADS. The election generally must cover all property in the same property class that you placed in service during the year. However, the election for residential rental property and nonresidential real property can be made on a property-by-property basis. Once you make this election, you can never revoke it.

You make the election by completing line 20 in Part III of Form 4562.

Which Property Class Applies Under GDS?

The following is a list of the nine property classifications under GDS and examples of the types of property included in each class. These property classes are also listed under column (a) in section B, Part III, of Form 4562. For detailed information on property classes, see Appendix B, Table of Class Lives and Recovery Periods, in this publication.

1. 3-year property.
    a. Tractor units for over-the-road use.
    b. Any race horse over 2 years old when placed in service. (All race horses placed in service after December 31, 2008, and before January 1, 2014, are deemed to be 3-year property, regardless of age.)
    c. Any other horse (other than a race horse) over 12 years old when placed in service.
    d. Qualified rent-to-own property (defined later).
2. 5-year property.
    a. Automobiles, taxis, buses, and trucks.
    b. Computers and peripheral equipment.
    c. Office machinery (such as typewriters, calculators, and copiers).
    d. Any property used in research and experimentation.
    e. Breeding cattle and dairy cattle.
    f. Appliances, carpets, furniture, etc., used in a residential rental real estate activity.
    g. Certain geothermal, solar, and wind energy property.
3. 7-year property.
    a. Office furniture and fixtures (such as desks, files, and safes).
    b. Agricultural machinery and equipment.
    c. Any property that does not have a class life and has not been designated by law as being in any other class.
    d. Certain motorsports entertainment complex property placed in service before January 1, 2012 (defined later).
    e. Any natural gas gathering line placed in service after April 11, 2005. See *Natural gas gathering line, natural gas distribution line, and electric transmission property*, later.
4. 10-year property.
    a. Vessels, barges, tugs, and similar water transportation equipment.
    b. Any single purpose agricultural or horticultural structure.
    c. Any tree or vine bearing fruits or nuts.
    d. Qualified small electric meter and qualified smart electric grid system (defined later) placed in service on or after October 3, 2008.
5. 15-year property.
    a. Certain improvements made directly to land or added to it (such as shrubbery, fences, roads, sidewalks, and bridges).
    b. Any retail motor fuels outlet (defined later), such as a convenience store.
    c. Any municipal wastewater treatment plant.

   d. Any qualified leasehold improvement property (defined later) placed in service before January 1, 2012.

   e. Any qualified restaurant property (defined later) placed in service before January 1, 2012.

   f. Initial clearing and grading land improvements for gas utility property.

   g. Electric transmission property (that is section 1245 property) used in the transmission at 69 or more kilovolts of electricity placed in service after April 11, 2005. See *Natural gas gathering line, natural gas distribution line, and electric transmission property*, later.

   h. Any natural gas distribution line placed in service after April 11, 2005. See *Natural gas gathering line, natural gas distribution line, and electric transmission property*, later.

   i. Any qualified retail improvement property placed in service before January 1, 2012.

6. 20-year property.

   a. Farm buildings (other than single purpose agricultural or horticultural structures).

   b. Municipal sewers not classified as 25-year property.

   c. Initial clearing and grading land improvements for electric utility transmission and distribution plants.

7. 25-year property. This class is water utility property, which is either of the following.

   a. Property that is an integral part of the gathering, treatment, or commercial distribution of water, and that, without regard to this provision, would be 20-year property.

   b. Municipal sewers other than property placed in service under a binding contract in effect at all times since June 9, 1996.

8. Residential rental property. This is any building or structure, such as a rental home (including a mobile home), if 80% or more of its gross rental income for the tax year is from dwelling units. A dwelling unit is a house or apartment used to provide living accommodations in a building or structure. It does not include a unit in a hotel, motel, or other establishment where more than half the units are used on a transient basis. If you occupy any part of the building or structure for personal use, its gross rental income includes the fair rental value of the part you occupy.

9. Nonresidential real property. This is section 1250 property, such as an office building, store, or warehouse, that is neither residential rental property nor property with a class life of less than 27.5 years.

If your property is not listed above, you can determine its property class from the *Table of Class Lives and Recovery Periods* in Appendix B. The property class is generally the same as the GDS recovery period indicated in the table.

Qualified rent-to-own property. Qualified rent-to-own property is property held by a rent-to-own dealer for purposes of being subject to a rent-to-own contract. It is tangible personal property generally used in the home for personal use. It includes computers and peripheral equipment, televisions, videocassette recorders, stereos, camcorders, appliances, furniture, washing machines and dryers, refrigerators, and other similar consumer durable property. Consumer durable property does not include real property, aircraft, boats, motor vehicles, or trailers.

If some of the property you rent to others under a rent-to-own agreement is of a type that may be used by the renters for either personal or business purposes, you still can treat this property as qualified property as long as it does not represent a significant portion of your leasing property. However, if this dual-use property does represent a significant portion of your leasing property, you must prove that this property is qualified rent-to-own property.

Rent-to-own dealer. You are a rent-to-own dealer if you meet all the following requirements.

- You regularly enter into rent-to-own contracts in the ordinary course of your business for the use of consumer property.
- A substantial portion of these contracts end with the customer returning the property before making all the payments required to transfer ownership.
- The property is tangible personal property of a type generally used within the home for personal use.

Rent-to-own contract. This is any lease for the use of consumer property between a rent-to-own dealer and a customer who is an individual which—

- Is titled “Rent-to-Own Agreement,” “Lease Agreement with Ownership Option,” or other similar language.
- Provides a beginning date and a maximum period of time, not to exceed 156 weeks or 36 months from the beginning date, for which the contract can be in effect (including renewals or options to extend).
- Provides for regular periodic (weekly or monthly) payments that can be either level or decreasing. If the payments are decreasing, no payment can be less than 40% of the largest payment.
- Provides for total payments that generally exceed the normal retail price of the property plus interest.
- Provides for total payments that do not exceed $10,000 for each item of property.
- Provides that the customer has no legal obligation to make all payments outlined in the contract and that, at the end of each weekly or monthly payment period, the customer can either continue to use the property by making the next payment or return the property in good working order with no further obligations and no entitlement to a return of any prior payments.
- Provides that legal title to the property remains with the rent-to-own dealer until the customer makes either all the required payments or the early purchase payments required under the contract to acquire legal title.
- Provides that the customer has no right to sell, sublease, mortgage, pawn, pledge, or otherwise dispose of the property until all contract payments have been made.

Motorsports entertainment complex. This is a racing track facility permanently situated on land that hosts one or more racing events for automobiles, trucks, or motorcycles during the 36-month period after the first day of the month in which the facility is placed in service. The events must be open to the public for the price of admission.

Qualified smart electric grid system. A qualified smart electric grid system means any smart grid property used as part of a system for electric distribution grid communications, monitoring, and management placed in service after October 3, 2008, by a taxpayer who is a supplier of electrical energy or a provider of electrical energy services. Smart grid property includes electronics and related equipment that is capable of:

- Sensing, collecting, and monitoring data of or from all portions of a utility's electric distribution grid,
- Providing real-time, two-way communications to monitor or to manage the grid, and
- Providing real-time analysis of an event prediction based on collected data that can be used to provide electric distribution system reliability, quality, and performance.

Retail motor fuels outlet. Real property is a retail motor fuels outlet if it is used to a substantial extent in the retail marketing of petroleum or petroleum products (whether or not it is also used to sell food or other convenience items) and meets any one of the following three tests.

- It is not larger than 1,400 square feet.
- 50% or more of the gross revenues generated from the property are derived from petroleum sales.
- 50% or more of the floor space in the property is devoted to petroleum marketing sales.

A retail motor fuels outlet does not include any facility related to petroleum and natural gas trunk pipelines.

Qualified leasehold improvement property. Generally, this is any improvement to an interior part of a building (placed in service before January 1, 2012) that is nonresidential real property, provided all of the requirements discussed in chapter 3 under *Qualified leasehold improvement property* are met.

In addition, an improvement made by the lessor does not qualify as qualified leasehold improvement property to any subsequent owner unless it is acquired from the original lessor by reason of the lessor's death or in any of the following types of transactions.

1. A transaction to which section 381(a) applies,
2. A mere change in the form of conducting the trade or business so long as the property is retained in the trade or business as qualified leasehold improvement property and the taxpayer retains a substantial interest in the trade or business,
3. A like-kind exchange, involuntary conversion, or reacquisition of real property to the extent that the basis in the property represents the carryover basis, or
4. Certain nonrecognition transactions to the extent that your basis in the property is determined by reference to the transferor's or distributor's basis in the property. Examples include the following.
    a. A complete liquidation of a subsidiary.
    b. A transfer to a corporation controlled by the transferor.
    c. An exchange of property by a corporation solely for stock or securities in another corporation in a reorganization.

Qualified restaurant property. Qualified restaurant property is any section 1250 property that is a building placed in service after December 31, 2008, and before January 1, 2012. Also, more than 50% of the building's square footage must be devoted to preparation of meals and seating for on-premises consumption of prepared meals.

Qualified smart electric meter. A qualified smart electric meter is any time-based meter and related communication equipment which is placed in service by a supplier of electric energy or a provider of electric energy services and which is capable of being used by you as part of a system that:

- Measures and records electricity usage data on a time-differentiated basis in at least 24 separate time segments per day;
- Provides for the exchange of information between the supplier or provider and the customer's smart electric meter in support of time-based rates or other forms of demand response;
- Provides data to the supplier or provider so that the supplier or provider can provide energy usage information to customers electronically, and
- Provides all commercial and residential customers of such supplier or provider with net metering. Net metering means allowing a customer a credit, if any, as complies with applicable federal and state laws and regulations for providing electricity to the supplier or provider.

Natural gas gathering line, natural gas distribution line, and electric transmission property. Any natural gas gathering line placed in service after April 11, 2005, is treated as 7-year property, and electric transmission property (that is section 1245 property) used in the transmission at 69 or more kilovolts of electricity and any natural gas distribution line placed in service after April 11, 2005, are treated as 15-year property, if the following requirements are met.

- The original use of the property must have begun with you after April 11, 2005. Original use means the first use to which the property is put, whether or not by you. Therefore, property used by any person before April 12, 2005, is not original use. Original use includes additional capital expenditures you incurred to recondition or rebuild your property. However, original use does not include the cost of reconditioned or rebuilt property you acquired. Property containing used parts will not be treated as reconditioned or rebuilt if the cost of the used parts is not more than 20% of the total cost of the property.
- The property must not be placed in service under a binding contract in effect before April 12, 2005.
- The property must not be self-constructed property (property you manufacture, construct, or produce for your own use), if you began the manufacture, construction, or production of the property before April 12, 2005. Property that is manufactured, constructed, or produced for your use by another person under a written binding contract entered into by you or a related party before the manufacture, construction, or production of the property is considered to be manufactured, constructed, or produced by you.

What Is the Placed in Service Date?

You begin to claim depreciation when your property is placed in service for either use in a trade or business or the production of income. The placed in service date for your property is the date the property is ready and available for a specific use. It is therefore not necessarily the date it is first used. If you converted property held for personal use to use in a trade or business or for the production of income, treat the property as being placed in service on the conversion date. See *Placed in Service* under *When Does Depreciation Begin and End* in chapter 1 for examples illustrating when property is placed in service.

What Is the Basis for Depreciation?

The basis for depreciation of MACRS property is the property's cost or other basis multiplied by the percentage of business/investment use. For a discussion of business/investment use, see *Partial business or investment use* under *Property Used in Your Business or Income-Producing Activity* in chapter 1. Reduce that amount by any credits and deductions allocable to the property. The following are examples of some credits and deductions that reduce basis.

- Any deduction for section 179 property.
- Any deduction under section 179B of the Internal Revenue Code for capital costs to comply with Environmental Protection Agency sulfur regulations.
- Any deduction under section 179C of the Internal Revenue Code for certain qualified refinery property placed in service after August 8, 2005.
- Any deduction under section 179D of the Internal Revenue Code for certain energy efficient commercial building property placed in service after December 31, 2005.
- Any deduction under section 179E of the Internal Revenue Code for qualified advanced mine safety equipment property placed in service after December 20, 2006.
- Any deduction for removal of barriers to the disabled and the elderly.
- Any disabled access credit, enhanced oil recovery credit, and credit for employer-provided childcare facilities and services.
- Any special depreciation allowance.
- Basis adjustment for investment credit property under section 50(c) of the Internal Revenue Code.

For additional credits and deductions that affect basis, see section 1016 of the Internal Revenue Code.

Enter the basis for depreciation under column (c) in Part III of Form 4562. For information about how to determine the cost or other basis of property, see *What Is the Basis of Your Depreciable Property* in chapter 1.

Which Recovery Period Applies?

The recovery period of property is the number of years over which you recover its cost or other basis. It is determined based on the depreciation system (GDS or ADS) used.

Recovery Periods Under GDS

Under GDS, property that is not qualified Indian reservation property is depreciated over one of the following recovery periods.

Property Class	Recovery Period
3-year property	3 years[1]
5-year property	5 years
7-year property	7 years
10-year property	10 years
15-year property	15 years[2]
20-year property	20 years
25-year property	25 years[3]
Residential rental property	27.5 years
Nonresidential real property	39 years[4]

[1]5 years for qualified rent-to-own property placed in service before August 6, 1997.

[2]39 years for property that is a retail motor fuels outlet placed in service before August 20, 1996 (31.5 years if placed in service before May 13, 1993), unless you elected to depreciate it over 15 years.

[3]20 years for property placed in service before June 13, 1996, or under a binding contract in effect before June 10, 1996.

[4]31.5 years for property placed in service before May 13, 1993 (or before January 1, 1994, if the purchase or construction of the property is under a binding contract in effect before May 13, 1993, or if construction began before May 13, 1993).

The GDS recovery periods for property not listed above can be found in Appendix B, *Table of Class Lives and Recovery Periods*. Residential rental property and nonresidential real property are defined earlier under *Which Property Class Applies Under GDS*.

Enter the appropriate recovery period on Form 4562 under column (d) in section B of Part III, unless already shown (for 25-year property, residential rental property, and nonresidential real property).

Office in the home. If your home is a personal-use single family residence and you begin to use part of your home as an office, depreciate that part of your home as nonresidential real property over 39 years (31.5 years if you began using it for business before May 13, 1993). However, if your home is an apartment in an apartment building that you own and the building is residential rental property as defined earlier under *Which Property Class Applies Under GDS*, depreciate the part used as an office as residential rental property over 27.5 years. See Publication 587 for a discussion of the tests you must meet to claim expenses, including depreciation, for the business use of your home.

Home changed to rental use. If you begin to rent a home that was your personal home before 1987, you depreciate it as residential rental property over 27.5 years.

Indian Reservation Property

The recovery periods for qualified property you placed in service on an Indian reservation after 1993 and before 2012 are shorter than those listed earlier. The following table shows these shorter recovery periods.

Property Class	Recovery Period
3-year property	2 years
5-year property	3 years
7-year property	4 years
10-year property	6 years
15-year property	9 years
20-year property	12 years

Nonresidential real property	22 years

Nonresidential real property is defined earlier under *Which Property Class Applies Under GDS*.

Use this chart to find the correct percentage table to use for qualified Indian reservation property.

IF your recovery period is:	**THEN** use the following table in Appendix A:
2 years	A-21
3 years	A-1, A-2, A-3, A-4, or A-5
4 years	A-22
6 years	A-23
9 years	A-14, A-15, A-16, A-17, or A-18
12 years	A-14, A-15, A-16, A-17, or A-18
22 years	A-24

Qualified property. Property eligible for the shorter recovery periods are 3-, 5-, 7-, 10-, 15-, and 20-year property and nonresidential real property. You must use this property predominantly in the active conduct of a trade or business within an Indian reservation. The rental of real property that is located on an Indian reservation is treated as the active conduct of a trade or business within an Indian reservation.

The following property is not qualified property.

1. Property used or located outside an Indian reservation on a regular basis, other than qualified infrastructure property.
2. Property acquired directly or indirectly from a related person.
3. Property placed in service for purposes of conducting or housing class I, II, or III gaming activities. These activities are defined in section 4 of the Indian Regulatory Act (25 U.S.C. 2703).
4. Any property you must depreciate under ADS. Determine whether property is qualified without regard to the election to use ADS and after applying the special rules for listed property not used predominantly for qualified business use (discussed in chapter 5).

Qualified infrastructure property. Item (1) above does not apply to qualified infrastructure property located outside the reservation that is used to connect with qualified infrastructure property within the reservation. Qualified infrastructure property is property that meets all the following rules.

- It is qualified property, as defined earlier, except that it is outside the reservation.
- It benefits the tribal infrastructure.
- It is available to the general public.
- It is placed in service in connection with the active conduct of a trade or business within a reservation.

Infrastructure property includes, but is not limited to, roads, power lines, water systems, railroad spurs, and communications facilities.

Related person. For purposes of item (2) above, see *Related persons* in the discussion on property owned or used in 1986 under *Which Method Can You Use To Depreciate Your Property* in chapter 1 for a description of related persons.

Indian reservation. The term Indian reservation means a reservation as defined in section 3(d) of the Indian Financing Act of 1974 (25 U.S.C. 1452(d)) or section 4(10) of the Indian Child Welfare Act of 1978 (25 U.S.C. 1903(10)). Section 3(d) of the Indian Financing Act of 1974 defines reservation to include former Indian reservations in Oklahoma. For a definition of the term "former Indian reservations in Oklahoma," see Notice 98-45 in Internal Revenue Bulletin 1998-35.

Recovery Periods Under ADS

The recovery periods for most property generally are longer under ADS than they are under GDS. The following table shows some of the ADS recovery periods.

Property	Recovery Period
Rent-to-own property	4 years
Automobiles and light duty trucks	5 years
Computers and peripheral equipment	5 years
High technology telephone station equipment installed on customer premises	5 years
High technology medical equipment	5 years
Personal property with no class life	12 years
Natural gas gathering lines	14 years
Single purpose agricultural and horticultural structures	15 years
Any tree or vine bearing fruit or nuts	20 years
Initial clearing and grading land improvements for gas utility property	20 years
Initial clearing and grading land improvements for electric utility transmission and distribution plants	25 years
Electric transmission property used in the transmission at 69 or more kilovolts of electricity	30 years
Natural gas distribution lines	35 years
Any qualified leasehold improvement property	39 years
Any qualified restaurant property	39 years
Nonresidential real property	40 years
Residential rental property	40 years
Section 1245 real property not listed in Appendix B	40 years
Railroad grading and tunnel bore	50 years

The ADS recovery periods for property not listed above can be found in the tables in Appendix B. Rent-to-own property, qualified leasehold improvement property, qualified restaurant property, residential rental property, and nonresidential real property are defined earlier under *Which Property Class Applies Under GDS*.

Tax-exempt use property subject to a lease. The ADS recovery period for any property leased under a lease agreement to a tax-exempt organization, governmental unit, or foreign person or entity (other than a partnership) cannot be less than 125% of the lease term.

Additions and Improvements

An addition or improvement you make to depreciable property is treated as separate depreciable property. See *How Do You Treat Repairs and Improvements* in chapter 1 for a definition of improvements. Its property class and recovery period are the same as those that would apply to the original property if you had placed it in service at the same time you placed the addition or improvement in service. The recovery period begins on the later of the following dates.

- The date you place the addition or improvement in service.
- The date you place in service the property to which you made the addition or improvement.

If the improvement you make is qualified leasehold improvement property or qualified restaurant property (defined earlier under Which Property Class Applies Under GDS), the GDS recovery period is 15 years (39 years under ADS).

Example.

You own a rental home that you have been renting out since 1981. If you put an addition on the home and place the addition in service this year, you would use MACRS to figure your depreciation deduction for the addition. Under GDS, the property class for the addition is residential rental property and its recovery period is 27.5 years because the home to which the addition is made would be residential rental property if you had placed it in service this year.

Which Convention Applies?

Under MACRS, averaging conventions establish when the recovery period begins and ends. The convention you use determines the number of months for which you can claim depreciation in the year you place property in service and in the year you dispose of the property.

The mid-month convention. Use this convention for nonresidential real property, residential rental property, and any railroad grading or tunnel bore.

Under this convention, you treat all property placed in service or disposed of during a month as placed in service or disposed of at the midpoint of the month. This means that a one-half month of depreciation is allowed for the month the property is placed in service or disposed of.

Your use of the mid-month convention is indicated by the “MM” already shown under column (e) in Part III of Form 4562.

The mid-quarter convention. Use this convention if the mid-month convention does not apply and the total depreciable bases of MACRS property you placed in service during the last 3 months of the tax year (excluding nonresidential real property, residential rental property, any railroad grading or tunnel bore, property placed in service and disposed of in the same year, and property that is being depreciated under a method other than MACRS) are more than 40% of the total depreciable bases of all MACRS property you placed in service during the entire year.

Under this convention, you treat all property placed in service or disposed of during any quarter of the tax year as placed in service or disposed of at the midpoint of that quarter. This means that 1½ months of depreciation is allowed for the quarter the property is placed in service or disposed of.

If you use this convention, enter “MQ” under column (e) in Part III of Form 4562.

For purposes of determining whether the mid-quarter convention applies, the depreciable basis of property you placed in service during the tax year reflects the reduction in basis for amounts expensed under section 179 and the part of the basis of property attributable to personal use. However, it does not reflect any reduction in basis for any special depreciation allowance.

The half-year convention. Use this convention if neither the mid-quarter convention nor the mid-month convention applies.

Under this convention, you treat all property placed in service or disposed of during a tax year as placed in service or disposed of at the midpoint of the year. This means that a one-half year of depreciation is allowed for the year the property is placed in service or disposed of.

If you use this convention, enter “HY” under column (e) in Part III of Form 4562.

Which Depreciation Method Applies?

MACRS provides three depreciation methods under GDS and one depreciation method under ADS.

- The 200% declining balance method over a GDS recovery period.
- The 150% declining balance method over a GDS recovery period.
- The straight line method over a GDS recovery period.
- The straight line method over an ADS recovery period.

For property placed in service before 1999, you could have elected the 150% declining balance method using the ADS recovery periods for certain property classes. If you made this election, continue to use the same method and recovery period for that property.

Table 4-1 lists the types of property you can depreciate under each method. It also gives a brief explanation of the method,

including any benefits that may apply.

Depreciation Methods for Farm Property

If you place personal property in service in a farming business after 1988, you generally must depreciate it under GDS using the 150% declining balance method unless you are a farmer who must depreciate the property under ADS using the straight line method or you elect to depreciate the property under GDS or ADS using the straight line method. You can depreciate real property using the straight line method under either GDS or ADS.

Fruit or nut trees and vines. Depreciate trees and vines bearing fruit or nuts under GDS using the straight line method over a recovery period of 10 years.

ADS required for some farmers. If you elect not to apply the uniform capitalization rules to any plant produced in your farming business, you must use ADS. You must use ADS for all property you place in service in any year the election is in effect. See the regulations under section 263A of the Internal Revenue Code for information on the uniform capitalization rules that apply to farm property.

Electing a Different Method

As shown in *Table 4-1*, you can elect a different method for depreciation for certain types of property. You must make the election by the due date of the return (including extensions) for the year you placed the property in service. However, if you timely filed your return for the year without making the election, you still can make the election by filing an amended return within 6 months of the due date of the return (excluding extensions). Attach the election to the amended return and write "Filed pursuant to section 301.9100-2" on the election statement. File the amended return at the same address you filed the original return. Once you make the election, you cannot change it.

CAUTION

If you elect to use a different method for one item in a property class, you must apply the same method to all property in that class placed in service during the year of the election. However, you can make the election on a property-by-property basis for nonresidential real and residential rental property.

150% election. Instead of using the 200% declining balance method over the GDS recovery period for nonfarm property in the 3-, 5-, 7-, and 10-year property classes, you can elect to use the 150% declining balance method. Make the election by entering "150 DB" under column (f) in Part III of Form 4562.

Straight line election. Instead of using either the 200% or 150% declining balance methods over the GDS recovery period, you can elect to use the straight line method over the GDS recovery period. Make the election by entering "S/L" under column (f) in Part III of Form 4562.

Election of ADS. As explained earlier under *Which Depreciation System (GDS or ADS) Applies*, you can elect to use ADS even though your property may come under GDS. ADS uses the straight line method of depreciation over fixed ADS recovery periods. Most ADS recovery periods are listed in Appendix B, or see the table under *Recovery Periods Under ADS*, earlier.

Make the election by completing line 20 in Part III of Form 4562.

Farm property. Instead of using the 150% declining balance method over a GDS recovery period for property you use in a farming business (other than real property), you can elect to depreciate it using either of the following methods.

- The straight line method over a GDS recovery period.
- The straight line method over an ADS recovery period.

Table 4-1. Depreciation Methods

Note. The declining balance method is abbreviated as DB and the straight line method is abbreviated as SL.		
Method	**Type of Property**	**Benefit**
GDS using 200% DB	• Nonfarm 3-, 5-, 7-, and 10-year property	• Provides a greater deduction during the earlier recovery years • Changes to SL when that method provides an equal or greater deduction
GDS using 150% DB	• All farm property (except real property) • All 15- and 20-year property (except qualified leasehold improvement property and qualified restaurant property placed in service before January 1, 2012) • Nonfarm 3-, 5-, 7-, and 10-year property	• Provides a greater deduction during the earlier recovery years • Changes to SL when that method provides an equal or greater deduction[1]
GDS using SL	• Nonresidential real property • Qualified leasehold improvement property placed in service before January 1, 2012 • Qualified restaurant property placed in service before January 1, 2012 • Residential rental property • Trees or vines bearing fruit or nuts • Water utility property • All 3-, 5-, 7-, 10-, 15-, and 20-year property[2] • Property for which you elected section 168(k)(4)	• Provides for equal yearly deductions (except for the first and last years)
ADS using SL	• Listed property used 50% or less for business • Property used predominantly outside the U.S. • Qualified leasehold improvement property placed in service before January 1, 2012 • Qualified restaurant property placed in service before January 1, 2012 • Tax-exempt property • Tax-exempt bond-financed property • Farm property used when an election not to apply the uniform capitalization rules is in effect • Imported property[3] • Any property for which you elect to use this method[2]	• Provides for equal yearly deductions

Note. The declining balance method is abbreviated as DB and the straight line method is abbreviated as SL.
[1]The MACRS percentage tables in Appendix A have the switch to the straight line method built into their rates
[2]See section 168(g)(7) of the Internal Revenue Code.
[3]See section 168(g)(6) of the Internal Revenue Code

How Is the Depreciation Deduction Figured?

To figure your depreciation deduction under MACRS, you first determine the depreciation system, property class, placed in service date, basis amount, recovery period, convention, and depreciation method that applies to your property. Then, you are ready to figure your depreciation deduction. You can figure it using a percentage table provided by the IRS, or you can figure it yourself without using the table.

Using the MACRS Percentage Tables

To help you figure your deduction under MACRS, the IRS has established percentage tables that incorporate the applicable convention and depreciation method. These percentage tables are in Appendix A near the end of this publication.

Which table to use. Appendix A contains the *MACRS Percentage Table Guide,* which is designed to help you locate the correct percentage table to use for depreciating your property. The percentage tables immediately follow the guide.

Rules Covering the Use of the Tables

The following rules cover the use of the percentage tables.

1. You must apply the rates in the percentage tables to your property's unadjusted basis.
2. You cannot use the percentage tables for a short tax year. See *Figuring the Deduction for a Short Tax Year,* later, for information on the short tax year rules.
3. Once you start using the percentage tables for any item of property, you generally must continue to use them for the entire recovery period of the property.
4. You must stop using the tables if you adjust the basis of the property for any reason other than—
    a. Depreciation allowed or allowable, or
    b. An addition or improvement to that property that is depreciated as a separate item of property.

Basis adjustments other than those made due to the items listed in (4) include an increase in basis for the recapture of a clean-fuel deduction or credit and a reduction in basis for a casualty loss.

Basis adjustment due to recapture of clean-fuel vehicle deduction or credit. If you increase the basis of your property because of the recapture of part or all of a deduction for clean-fuel vehicles or the credit for clean-fuel vehicle refueling property placed in service before January 1, 2006, you cannot continue to use the percentage tables. For the year of the adjustment and the remaining recovery period, you must figure the depreciation deduction yourself using the property's adjusted basis at the end of the year. See *Figuring the Deduction Without Using the Tables,* later.

Basis adjustment due to casualty loss. If you reduce the basis of your property because of a casualty, you cannot continue to use the percentage tables. For the year of the adjustment and the remaining recovery period, you must figure the depreciation yourself using the property's adjusted basis at the end of the year. See *Figuring the Deduction Without Using the Tables,* later.

Example.

On October 26, 2009, Sandra Elm, a calendar year taxpayer, bought and placed in service in her business in the GO Zone a new item of 7-year property. It cost $39,000 and she elected a section 179 deduction of $24,000. She also took a special depreciation allowance of $7,500 [50% of $15,000 ($39,000 − $24,000)]. Her unadjusted basis after the section 179 deduction and special depreciation allowance was $7,500 ($15,000 − $7,500). She figured her MACRS depreciation deduction using the percentage tables. For 2009, her MACRS depreciation deduction was $268.

In July 2010, the property was vandalized and Sandra had a deductible casualty loss of $3,000. She must adjust the property's basis for the casualty loss, so she can no longer use the percentage tables. Her adjusted basis at the end of 2010, before figuring her 2010 depreciation, is $4,232. She figures that amount by subtracting the 2009 MACRS depreciation of $268 and the casualty loss of $3,000 from the unadjusted basis of $7,500. She must now figure her depreciation for 2010 without using the percentage tables.

Figuring the Unadjusted Basis of Your Property

You must apply the table rates to your property's unadjusted basis each year of the recovery period. Unadjusted basis is the same basis amount you would use to figure gain on a sale, but you figure it without reducing your original basis by any MACRS depreciation taken in earlier years. However, you do reduce your original basis by other amounts, including the following.

- Any amortization taken on the property.
- Any section 179 deduction claimed.
- Any special depreciation allowance taken on the property.

For business property you purchase during the year, the unadjusted basis is its cost minus these and other applicable adjustments. If you trade property, your unadjusted basis in the property received is the cash paid plus the adjusted basis of the property traded minus these adjustments.

MACRS Worksheet

You can use this worksheet to help you figure your depreciation deduction using the percentage tables. Use a separate worksheet for each item of property. Then, use the information from this worksheet to prepare Form 4562.

Do not use this worksheet for automobiles. Use the Depreciation Worksheet for Passenger Automobiles in chapter 5.

MACRS Worksheet

	Part I			
1.	MACRS system (GDS or ADS)			
2.	Property class			
3.	Date placed in service			
4.	Recovery period			
5.	Method and convention			
6.	Depreciation rate (from tables)			
	Part II			
7.	Cost or other basis*	$		
8.	Business/investment use		%	
9.	Multiply line 7 by line 8			$
10.	Total claimed for section 179 deduction and other items			$
11.	Subtract line 10 from line 9. This is your tentative basis for depreciation			$
12.	Multiply line 11 by .50 if the 50% special depreciation allowance applies. Multiply line 11 by 1.00 if the 100% special depreciation allowance applies. This is your special depreciation allowance. Enter -0- if this is not the year you placed the property in service, the property is not qualified property, or you elected not to claim a special allowance			$
13.	Subtract line 12 from line 11. This is your basis for depreciation			
14.	Depreciation rate (from line 6)			
15.	Multiply line 13 by line 14. This is your MACRS depreciation deduction			$

*If real estate, do not include cost (basis) of land.

The following example shows how to figure your MACRS depreciation deduction using the percentage tables and the MACRS worksheet.

Example.

You bought office furniture (7-year property) for $10,000 and placed it in service on August 11, 2010. You use the furniture only for business. This is the only property you placed in service this year. You did not elect a section 179 deduction and the property is not qualified property for purposes of claiming a special depreciation allowance so your property's unadjusted basis is its cost, $10,000. You use GDS and the half-year convention to figure your depreciation. You refer to the *MACRS Percentage Table Guide* in Appendix A and find that you should use Table A-1. Multiply your property's unadjusted basis each year by the percentage for 7-year property given in Table A-1. You figure your depreciation deduction using the MACRS worksheet as follows.

MACRS Worksheet

	Part I			
1.	MACRS system (GDS or ADS)			GDS
2.	Property class			7-year
3.	Date placed in service			8/11/10
4.	Recovery period			7-Year
5.	Method and convention			200%DB/Half-Year
6.	Depreciation rate (from tables)			.1429
	Part II			
7.	Cost or other basis*	$10,000		
8.	Business/investment use	100	%	
9.	Multiply line 7 by line 8			$10,000
10.	Total claimed for section 179 deduction and other items			-0-
11.	Subtract line 10 from line 9. This is your tentative basis for depreciation			$10,000
12.	Multiply line 11 by .50 if the 50% special depreciation allowance applies. Multiply line 11 by 1.00 if the 100% special depreciation allowance applies. This is your special depreciation allowance. Enter -0- if this is not the year you placed the property in service, the property is not qualified property, or you elected not to claim a special allowance			-0-
13.	Subtract line 12 from line 11. This is your basis for depreciation			$10,000
14.	Depreciation rate (from line 6)			.1429
15.	Multiply line 13 by line 14. This is your MACRS depreciation deduction			$1,429

*If real estate, do not include cost (basis) of land.

If there are no adjustments to the basis of the property other than depreciation, your depreciation deduction for each subsequent year of the recovery period will be as follows.

Year	Basis	Percentage	Deduction
2011	$ 10,000	24.49%	$2,449
2012	10,000	17.49	1,749
2013	10,000	12.49	1,249
2014	10,000	8.93	893
2015	10,000	8.92	892
2016	10,000	8.93	893
2017	10,000	4.46	446

Examples

The following examples are provided to show you how to use the percentage tables. In both examples, assume the following.

- You use the property only for business.
- You use the calendar year as your tax year.
- You use GDS for all the properties.

Example 1.

You bought a building and land for $120,000 and placed it in service on March 8. The sales contract showed that the building cost $100,000 and the land cost $20,000. It is nonresidential real property. The building's unadjusted basis is its

original cost, $100,000.

You refer to the *MACRS Percentage Table Guide* in Appendix A and find that you should use Table A-7a. March is the third month of your tax year, so multiply the building's unadjusted basis, $100,000, by the percentages for the third month in Table A-7a. Your depreciation deduction for each of the first 3 years is as follows:

Year	Basis	Percentage	Deduction
1st	$ 100,000	2.033%	$2,033
2nd	100,000	2.564	2,564
3rd	100,000	2.564	2,564

Example 2.

During the year, you bought a machine (7-year property) for $4,000, office furniture (7-year property) for $1,000, and a computer (5-year property) for $5,000. You placed the machine in service in January, the furniture in September, and the computer in October. You do not elect a section 179 deduction and none of these items is qualified property for purposes of claiming a special depreciation allowance.

You placed property in service during the last 3 months of the year, so you must first determine if you have to use the mid-quarter convention. The total bases of all property you placed in service during the year is $10,000. The $5,000 basis of the computer, which you placed in service during the last 3 months (the fourth quarter) of your tax year, is more than 40% of the total bases of all property ($10,000) you placed in service during the year. Therefore, you must use the mid-quarter convention for all three items.

You refer to the *MACRS Percentage Table Guide* in Appendix A to determine which table you should use under the mid-quarter convention. The machine is 7-year property placed in service in the first quarter, so you use Table A-2. The furniture is 7-year property placed in service in the third quarter, so you use Table A-4. Finally, because the computer is 5-year property placed in service in the fourth quarter, you use Table A-5. Knowing what table to use for each property, you figure the depreciation for the first 2 years as follows.

Year	Property	Basis	Percentage	Deduction
1st	Machine	$4,000	25.00	$1,000
2nd	Machine	4,000	21.43	857
1st	Furniture	1,000	10.71	107
2nd	Furniture	1,000	25.51	255
1st	Computer	5,000	5.00	250
2nd	Computer	5,000	38.00	1,900

Sale or Other Disposition Before the Recovery Period Ends

If you sell or otherwise dispose of your property before the end of its recovery period, your depreciation deduction for the year of the disposition will be only part of the depreciation amount for the full year. You have disposed of your property if you have permanently withdrawn it from use in your business or income-producing activity because of its sale, exchange, retirement, abandonment, involuntary conversion, or destruction. After you figure the full-year depreciation amount, figure the deductible part using the convention that applies to the property.

Half-year convention used. For property for which you used a half-year convention, the depreciation deduction for the year of the disposition is half the depreciation determined for the full year.

Mid-quarter convention used. For property for which you used the mid-quarter convention, figure your depreciation deduction for the year of the disposition by multiplying a full year of depreciation by the percentage listed below for the quarter in which you disposed of the property.

Quarter	Percentage
First	12.5%
Second	37.5
Third	62.5
Fourth	87.5

Example.

On December 2, 2007, you placed in service an item of 5-year property costing $10,000. You did not claim a section 179 deduction and the property does not qualify for a special depreciation allowance. Your unadjusted basis for the property was $10,000. You used the mid-quarter convention because this was the only item of business property you placed in service in 2007 and it was placed in service during the last 3 months of your tax year. Your property is in the 5-year property class, so you used Table A-5 to figure your depreciation deduction. Your deductions for 2007, 2008, and 2009 were $500 (5% of $10,000), $3,800 (38% of $10,000), and $2,280 (22.80% of $10,000). You disposed of the property on April 6, 2010. To determine your depreciation deduction for 2010, first figure the deduction for the full year. This is $1,368 (13.68% of $10,000). April is in the second quarter of the year, so you multiply $1,368 by 37.5% to get your depreciation deduction of $513 for 2010.

Mid-month convention used. If you dispose of residential rental or nonresidential real property, figure your depreciation deduction for the year of the disposition by multiplying a full year of depreciation by a fraction. The numerator of the fraction is the number of months (including partial months) in the year that the property is considered in service. The denominator is 12.

Example.

On July 2, 2008, you purchased and placed in service residential rental property. The property cost $100,000, not including the cost of land. You used Table A-6 to figure your MACRS depreciation for this property. You sold the property on March 2, 2010. You file your tax return based on the calendar year.

A full year of depreciation for 2010 is $3,636. This is $100,000 multiplied by .03636 (the percentage for the seventh month of the third recovery year) from Table A-6. You then apply the mid-month convention for the 2½ months of use in 2010. Treat the month of disposition as one-half month of use. Multiply $3,636 by the fraction, 2.5 over 12, to get your 2010 depreciation deduction of $757.50.

Figuring the Deduction Without Using the Tables

Instead of using the rates in the percentage tables to figure your depreciation deduction, you can figure it yourself. Before making the computation each year, you must reduce your adjusted basis in the property by the depreciation claimed the previous year.

CAUTION

Figuring MACRS deductions without using the tables generally will result in a slightly different amount than using the tables.

Declining Balance Method

When using a declining balance method, you apply the same depreciation rate each year to the adjusted basis of your property. You must use the applicable convention for the first tax year and you must switch to the straight line method beginning in the first year for which it will give an equal or greater deduction. The straight line method is explained later.

You figure depreciation for the year you place property in service as follows.

1. Multiply your adjusted basis in the property by the declining balance rate.
2. Apply the applicable convention.

You figure depreciation for all other years (before the year you switch to the straight line method) as follows.

1. Reduce your adjusted basis in the property by the depreciation allowed or allowable in earlier years.
2. Multiply this new adjusted basis by the same declining balance rate used in earlier years.

If you dispose of property before the end of its recovery period, see *Using the Applicable Convention,* later, for information on how to figure depreciation for the year you dispose of it.

Figuring depreciation under the declining balance method and switching to the straight line method is illustrated in *Example 1*, later, under *Examples*.

Declining balance rate. You figure your declining balance rate by dividing the specified declining balance percentage (150% or 200% changed to a decimal) by the number of years in the property's recovery period. For example, for 3-year property depreciated using the 200% declining balance method, divide 2.00 (200%) by 3 to get 0.6667, or a 66.67% declining balance rate. For 15-year property depreciated using the 150% declining balance method, divide 1.50 (150%) by 15 to get 0.10, or a 10% declining balance rate.

The following table shows the declining balance rate for each property class and the first year for which the straight line method gives an equal or greater deduction.

Property Class	Method	Declining Balance Rate	Year
3-year	200% DB	66.667%	3rd
5-year	200% DB	40.0	4th
7-year	200% DB	28.571	5th
10-year	200% DB	20.0	7th
15-year	150% DB	10.0	7th
20-year	150% DB	7.5	9th

Straight Line Method

When using the straight line method, you apply a different depreciation rate each year to the adjusted basis of your property. You must use the applicable convention in the year you place the property in service and the year you dispose of the property.

You figure depreciation for the year you place property in service as follows.

1. Multiply your adjusted basis in the property by the straight line rate.
2. Apply the applicable convention.

You figure depreciation for all other years (including the year you switch from the declining balance method to the straight line method) as follows.

1. Reduce your adjusted basis in the property by the depreciation allowed or allowable in earlier years (under any method).
2. Determine the depreciation rate for the year.
3. Multiply the adjusted basis figured in (1) by the depreciation rate figured in (2).

If you dispose of property before the end of its recovery period, see *Using the Applicable Convention*, later, for information on how to figure depreciation for the year you dispose of it.

Straight line rate. You determine the straight line depreciation rate for any tax year by dividing the number 1 by the years remaining in the recovery period at the beginning of that year. When figuring the number of years remaining, you must take into account the convention used in the year you placed the property in service. If the number of years remaining is less than 1, the depreciation rate for that tax year is 1.0 (100%).

Using the Applicable Convention

The applicable convention (discussed earlier under *Which Convention Applies*) affects how you figure your depreciation deduction for the year you place your property in service and for the year you dispose of it. It determines how much of the recovery period remains at the beginning of each year, so it also affects the depreciation rate for property you depreciate under the straight line method. See *Straight line rate* in the previous discussion. Use the applicable convention as explained in the following discussions.

Half-year convention. If this convention applies, you deduct a half-year of depreciation for the first year and the last year that you depreciate the property. You deduct a full year of depreciation for any other year during the recovery period.

Figure your depreciation deduction for the year you place the property in service by dividing the depreciation for a full year by 2. If you dispose of the property before the end of the recovery period, figure your depreciation deduction for the year of the disposition the same way. If you hold the property for the entire recovery period, your depreciation deduction for the year that includes the final 6 months of the recovery period is the amount of your unrecovered basis in the property.

Mid-quarter convention. If this convention applies, the depreciation you can deduct for the first year you depreciate the property depends on the quarter in which you place the property in service.

A quarter of a full 12-month tax year is a period of 3 months. The first quarter in a year begins on the first day of the tax year. The second quarter begins on the first day of the fourth month of the tax year. The third quarter begins on the first day of the seventh month of the tax year. The fourth quarter begins on the first day of the tenth month of the tax year. A calendar year is divided into the following quarters.

Quarter	Months
First	January, February, March
Second	April, May, June
Third	July, August, September
Fourth	October, November, December

Figure your depreciation deduction for the year you place the property in service by multiplying the depreciation for a full year by the percentage listed below for the quarter you place the property in service.

Quarter	Percentage
First	87.5%
Second	62.5
Third	37.5
Fourth	12.5

If you dispose of the property before the end of the recovery period, figure your depreciation deduction for the year of the disposition by multiplying a full year of depreciation by the percentage listed below for the quarter you dispose of the property.

Quarter	Percentage
First	12.5%
Second	37.5
Third	62.5
Fourth	87.5

If you hold the property for the entire recovery period, your depreciation deduction for the year that includes the final quarter of the recovery period is the amount of your unrecovered basis in the property.

Mid-month convention. If this convention applies, the depreciation you can deduct for the first year that you depreciate the property depends on the month in which you place the property in service. Figure your depreciation deduction for the year you place the property in service by multiplying the depreciation for a full year by a fraction. The numerator of the fraction is the number of full months in the year that the property is in service plus ½ (or 0.5). The denominator is 12.

If you dispose of the property before the end of the recovery period, figure your depreciation deduction for the year of the disposition the same way. If you hold the property for the entire recovery period, your depreciation deduction for the year that includes the final month of the recovery period is the amount of your unrecovered basis in the property.

Example.

You use the calendar year and place nonresidential real property in service in August. The property is in service 4 full months (September, October, November, and December). Your numerator is 4.5 (4 full months plus 0.5). You multiply the depreciation for a full year by 4.5/12, or 0.375.

Examples

The following examples show how to figure depreciation under MACRS without using the percentage tables. Figures are rounded for purposes of the examples. Assume for all the examples that you use a calendar year as your tax year.

Example 1—200% DB method and half-year convention.

In February, you placed in service depreciable property with a 5-year recovery period and a basis of $1,000. You do not elect to take the section 179 deduction and the property does not qualify for a special depreciation allowance. You use GDS and the 200% declining balance (DB) method to figure your depreciation. When the straight line (SL) method results in an equal or larger deduction, you switch to the SL method. You did not place any property in service in the last 3 months of the year, so you must use the half-year convention.

First year. You figure the depreciation rate under the 200% DB method by dividing 2 (200%) by 5 (the number of years in the recovery period). The result is 40%. You multiply the adjusted basis of the property ($1,000) by the 40% DB rate. You apply the half-year convention by dividing the result ($400) by 2. Depreciation for the first year under the 200% DB method is $200.

You figure the depreciation rate under the straight line (SL) method by dividing 1 by 5, the number of years in the recovery period. The result is 20%.You multiply the adjusted basis of the property ($1,000) by the 20% SL rate. You apply the half-year convention by dividing the result ($200) by 2. Depreciation for the first year under the SL method is $100.

The DB method provides a larger deduction, so you deduct the $200 figured under the 200% DB method.

Second year. You reduce the adjusted basis ($1,000) by the depreciation claimed in the first year ($200). You multiply the result ($800) by the DB rate (40%). Depreciation for the second year under the 200% DB method is $320.

You figure the SL depreciation rate by dividing 1 by 4.5, the number of years remaining in the recovery period. (Based on the half-year convention, you used only half a year of the recovery period in the first year.) You multiply the reduced adjusted basis ($800) by the result (22.22%). Depreciation under the SL method for the second year is $178.

The DB method provides a larger deduction, so you deduct the $320 figured under the 200% DB method.

Third year. You reduce the adjusted basis ($800) by the depreciation claimed in the second year ($320). You multiply the result ($480) by the DB rate (40%). Depreciation for the third year under the 200% DB method is $192.

You figure the SL depreciation rate by dividing 1 by 3.5. You multiply the reduced adjusted basis ($480) by the result (28.57%). Depreciation under the SL method for the third year is $137.

The DB method provides a larger deduction, so you deduct the $192 figured under the 200% DB method.

Fourth year. You reduce the adjusted basis ($480) by the depreciation claimed in the third year ($192). You multiply the result ($288) by the DB rate (40%). Depreciation for the fourth year under the 200% DB method is $115.

You figure the SL depreciation rate by dividing 1 by 2.5. You multiply the reduced adjusted basis ($288) by the result (40%). Depreciation under the SL method for the fourth year is $115.

The SL method provides an equal deduction, so you switch to the SL method and deduct the $115.

Fifth year. You reduce the adjusted basis ($288) by the depreciation claimed in the fourth year ($115) to get the reduced adjusted basis of $173. You figure the SL depreciation rate by dividing 1 by 1.5. You multiply the reduced adjusted basis ($173) by the result (66.67%). Depreciation under the SL method for the fifth year is $115.

Sixth year. You reduce the adjusted basis ($173) by the depreciation claimed in the fifth year ($115) to get the reduced adjusted basis of $58. There is less than one year remaining in the recovery period, so the SL depreciation rate for the sixth year is 100%. You multiply the reduced adjusted basis ($58) by 100% to arrive at the depreciation deduction for the sixth year ($58).

Example 2—SL method and mid-month convention.

In January, you bought and placed in service a building for $100,000 that is nonresidential real property with a recovery period of 39 years. The adjusted basis of the building is its cost of $100,000. You use GDS, the straight line (SL) method, and the mid-month convention to figure your depreciation.

First year. You figure the SL depreciation rate for the building by dividing 1 by 39 years. The result is .02564. The depreciation for a full year is $2,564 ($100,000 × .02564). Under the mid-month convention, you treat the property as placed in service in the middle of January. You get 11.5 months of depreciation for the year. Expressed as a decimal, the fraction of 11.5 months divided by 12 months is .958. Your first-year depreciation for the building is $2,456 ($2,564 × .958).

Second year. You subtract $2,456 from $100,000 to get your adjusted basis of $97,544 for the second year. The SL rate is .02629. This is 1 divided by the remaining recovery period of 38.042 years (39 years reduced by 11.5 months or .958 year). Your depreciation for the building for the second year is $2,564 ($97,544 × .02629).

Third year. The adjusted basis is $94,980 ($97,544 − $2,564). The SL rate is .027 (1 divided by 37.042 remaining years). Your depreciation for the third year is $2,564 ($94,980 × .027).

Example 3—200% DB method and mid-quarter convention.

During the year, you bought and placed in service in your business the following items.

Item	Month Placed in Service	Cost
Safe	January	$4,000
Office furniture	September	1,000
Computer (not listed property)	October	5,000

You do not elect a section 179 deduction and these items do not qualify for a special depreciation allowance. You use GDS and the 200% declining balance (DB) method to figure the depreciation. The total bases of all property you placed in service this year is $10,000. The basis of the computer ($5,000) is more than 40% of the total bases of all property placed in service during the year ($10,000), so you must use the mid-quarter convention. This convention applies to all three items of property. The safe and office furniture are 7-year property and the computer is 5-year property.

First and second year depreciation for safe. The 200% DB rate for 7-year property is .28571. You determine this by dividing 2.00 (200%) by 7 years. The depreciation for the safe for a full year is $1,143 ($4,000 × .28571). You placed the safe in service in the first quarter of your tax year, so you multiply $1,143 by 87.5% (the mid-quarter percentage for the first quarter). The result, $1,000, is your deduction for depreciation on the safe for the first year.

For the second year, the adjusted basis of the safe is $3,000. You figure this by subtracting the first year's depreciation ($1,000) from the basis of the safe ($4,000). Your depreciation deduction for the second year is $857 ($3,000 × .28571).

First and second year depreciation for furniture. The furniture is also 7-year property, so you use the same 200% DB rate of .28571. You multiply the basis of the furniture ($1,000) by .28571 to get the depreciation of $286 for the full year. You placed the furniture in service in the third quarter of your tax year, so you multiply $286 by 37.5% (the mid-quarter percentage for the third quarter). The result, $107, is your deduction for depreciation on the furniture for the first year.

For the second year, the adjusted basis of the furniture is $893. You figure this by subtracting the first year's depreciation ($107) from the basis of the furniture ($1,000). Your depreciation for the second year is $255 ($893 × .28571).

First and second year depreciation for computer. The 200% DB rate for 5-year property is .40. You determine this by dividing 2.00 (200%) by 5 years. The depreciation for the computer for a full year is $2,000 ($5,000 × .40). You placed the computer in service in the fourth quarter of your tax year, so you multiply the $2,000 by 12.5% (the mid-quarter percentage for the fourth quarter). The result, $250, is your deduction for depreciation on the computer for the first year.

For the second year, the adjusted basis of the computer is $4,750. You figure this by subtracting the first year's depreciation ($250) from the basis of the computer ($5,000). Your depreciation deduction for the second year is $1,900 ($4,750 × .40).

Example 4—200% DB method and half-year convention.

Last year, in July, you bought and placed in service in your business a new item of 7-year property. This was the only item of property you placed in service last year. The property cost $39,000 and you elected a $24,000 section 179 deduction. You also took a special depreciation allowance of $7,500. Your unadjusted basis for the property is $7,500. Because you did not place any property in service in the last 3 months of your tax year, you used the half-year convention. You figured your deduction using the percentages in Table A-1 for 7-year property. Last year, your depreciation was $1,072 ($7,500 × 14.29%).

In July of this year, your property was vandalized. You had a deductible casualty loss of $3,000. You spent $3,500 to put the property back in operational order. Your adjusted basis at the end of this year is $6,928. You figured this by first subtracting the first year's depreciation ($1,072) and the casualty loss ($3,000) from the unadjusted basis of $7,500. To this amount ($3,428), you then added the $3,500 repair cost.

You cannot use the table percentages to figure your depreciation for this property for this year because of the adjustments to basis. You must figure the deduction yourself. You determine the DB rate by dividing 2.00 (200%) by 7 years. The result is .28571 or 28.571%. You multiply the adjusted basis of your property ($6,928) by the declining balance rate of .28571 to get your depreciation deduction of $1,979 for this year.

Figuring the Deduction for Property Acquired in a Nontaxable Exchange

If your property has a carryover basis because you acquired it in a nontaxable transfer such as a like-kind exchange or involuntary conversion, you must generally figure depreciation for the property as if the transfer had not occurred. However, see *Like-kind exchanges and involuntary conversions*, earlier, in chapter 3 under *How Much Can You Deduct* and *Property Acquired in a Like-kind Exchange or Involuntary Conversion*, next.

Property Acquired in a Like-kind Exchange or Involuntary Conversion

You generally must depreciate the carryover basis of property acquired in a like-kind exchange or involuntary conversion over the remaining recovery period of the property exchanged or involuntarily converted. You also generally continue to use the same depreciation method and convention used for the exchanged or involuntarily converted property. This applies only to acquired property with the same or a shorter recovery period and the same or more accelerated depreciation method than the property exchanged or involuntarily converted. The excess basis (the part of the acquired property's basis that exceeds its carryover basis), if any, of the acquired property is treated as newly placed in service property.

For acquired property that has a longer recovery period or less accelerated depreciation method than the exchanged or involuntarily converted property, you generally must depreciate the carryover basis of the acquired property as if it were placed in service in the same tax year as the exchanged or involuntarily converted property. You also generally continue to use the longer recovery period and less accelerated depreciation method of the acquired property.

If the MACRS property you acquired in the exchange or involuntary conversion is qualified property, discussed earlier in chapter 3 under *What Is Qualified Property*, you can claim a special depreciation allowance on the carryover basis.

Special rules apply to vehicles acquired in a trade-in. For information on how to figure depreciation for a vehicle acquired in a trade-in that is subject to the passenger automobile limits, see *Deductions For Passenger Automobiles Acquired in a Trade-in* under *Do the Passenger Automobile Limits Apply* in chapter 5.

Election out. Instead of using the above rules, you can elect, for depreciation purposes, to treat the adjusted basis of the exchanged or involuntarily converted property as if disposed of at the time of the exchange or involuntary conversion. Treat the carryover basis and excess basis, if any, for the acquired property as if placed in service the later of the date you acquired it or the time of the disposition of the exchanged or involuntarily converted property. The depreciable basis of the new property is the adjusted basis of the exchanged or involuntarily converted property plus any additional amount you paid for it. The election, if made, applies to both the acquired property and the exchanged or involuntarily converted property. This election does not affect the amount of gain or loss recognized on the exchange or involuntary conversion.

When to make the election. You must make the election on a timely filed return (including extensions) for the year of replacement. The election must be made separately by each person acquiring replacement property. In the case of a partnership, S corporation, or consolidated group, the election is made by the partnership, by the S corporation, or by the common parent of a consolidated group, respectively. Once made, the election may not be revoked without IRS consent.

For more information and special rules, see the Instructions for Form 4562.

Property Acquired in a Nontaxable Transfer

You must depreciate MACRS property acquired by a corporation or partnership in certain nontaxable transfers over the property's remaining recovery period in the transferor's hands, as if the transfer had not occurred. You must continue to use the same depreciation method and convention as the transferor. You can depreciate the part of the property's basis that exceeds its carryover basis (the transferor's adjusted basis in the property) as newly purchased MACRS property.

The nontaxable transfers covered by this rule include the following.

- A distribution in complete liquidation of a subsidiary.
- A transfer to a corporation controlled by the transferor.
- An exchange of property solely for corporate stock or securities in a reorganization.
- A contribution of property to a partnership in exchange for a partnership interest.
- A partnership distribution of property to a partner.

Figuring the Deduction for a Short Tax Year

You cannot use the MACRS percentage tables to determine depreciation for a short tax year. A short tax year is any tax year with less than 12 full months. This section discusses the rules for determining the depreciation deduction for property you place in service or dispose of in a short tax year. It also discusses the rules for determining depreciation when you have a short tax year during the recovery period (other than the year the property is placed in service or disposed of).

For more information on figuring depreciation for a short tax year, see Revenue Procedure 89-15, 1989-1 C.B. 816.

Using the Applicable Convention in a Short Tax Year

The applicable convention establishes the date property is treated as placed in service and disposed of. Depreciation is allowable only for that part of the tax year the property is treated as in service. The recovery period begins on the placed in service date determined by applying the convention. The remaining recovery period at the beginning of the next tax year is the full recovery period less the part for which depreciation was allowable in the first tax year.

The following discussions explain how to use the applicable convention in a short tax year.

Mid-month convention. Under the mid-month convention, you always treat your property as placed in service or disposed of on the midpoint of the month it is placed in service or disposed of. You apply this rule without regard to your tax year.

Half-year convention. Under the half-year convention, you treat property as placed in service or disposed of on the midpoint of the tax year it is placed in service or disposed of.

First or last day of month. For a short tax year beginning on the first day of a month or ending on the last day of a month, the tax year consists of the number of months in the tax year. If the short tax year includes part of a month, you generally include the full month in the number of months in the tax year. You determine the midpoint of the tax year by dividing the number of months in the tax year by 2. For the half-year convention, you treat property as placed in service or disposed of on either the first day or the midpoint of a month.

For example, a short tax year that begins on June 20 and ends on December 31 consists of 7 months. You use only full months for this determination, so you treat the tax year as beginning on June 1 instead of June 20. The midpoint of the tax year is the middle of September (3½ months from the beginning of the tax year). You treat property as placed in service or disposed of on this midpoint.

Example.

Tara Corporation, a calendar year taxpayer, was incorporated on March 15. For purposes of the half-year convention, it has a short tax year of 10 months, ending on December 31, 2010. During the short tax year, Tara placed property in service for which it uses the half-year convention. Tara treats this property as placed in service on the first day of the sixth month of the short tax year, or August 1, 2010.

Not on first or last day of month. For a short tax year not beginning on the first day of a month and not ending on the last day of a month, the tax year consists of the number of days in the tax year. You determine the midpoint of the tax year by dividing the number of days in the tax year by 2. For the half-year convention, you treat property as placed in service or disposed of on either the first day or the midpoint of a month. If the result of dividing the number of days in the tax year by 2 is not the first day or the midpoint of a month, you treat the property as placed in service or disposed of on the nearest preceding first day or midpoint of a month.

Mid-quarter convention. To determine if you must use the mid-quarter convention, compare the basis of property you place in service in the last 3 months of your tax year to that of property you place in service during the full tax year. The length of your tax year does not matter. If you have a short tax year of 3 months or less, use the mid-quarter convention for all applicable property you place in service during that tax year.

You treat property under the mid-quarter convention as placed in service or disposed of on the midpoint of the quarter of the tax year in which it is placed in service or disposed of. Divide a short tax year into 4 quarters and determine the midpoint of each quarter.

For a short tax year of 4 or 8 full calendar months, determine quarters on the basis of whole months. The midpoint of each quarter is either the first day or the midpoint of a month. Treat property as placed in service or disposed of on this midpoint.

To determine the midpoint of a quarter for a short tax year of other than 4 or 8 full calendar months, complete the following steps.

1. Determine the number of days in your short tax year.
2. Determine the number of days in each quarter by dividing the number of days in your short tax year by 4.
3. Determine the midpoint of each quarter by dividing the number of days in each quarter by 2.

If the result of (3) gives you a midpoint of a quarter that is on a day other than the first day or midpoint of a month, treat the property as placed in service or disposed of on the nearest preceding first day or midpoint of that month.

Example.

Tara Corporation, a calendar year taxpayer, was incorporated and began business on March 15. It has a short tax year of 9½ months, ending on December 31. During December, it placed property in service for which it must use the mid-quarter convention. This is a short tax year of other than 4 or 8 full calendar months, so it must determine the midpoint of each quarter.

1. First, it determines that its short tax year beginning March 15 and ending December 31 consists of 292 days.
2. Next, it divides 292 by 4 to determine the length of each quarter, 73 days.
3. Finally, it divides 73 by 2 to determine the midpoint of each quarter, the 37th day.

The following table shows the quarters of Tara Corporation's short tax year, the midpoint of each quarter, and the date in each quarter that Tara must treat its property as placed in service.

Quarter	Midpoint	Placed in Service
3/15 – 5/26	4/20	4/15
5/27 – 8/07	7/02	7/01
8/08 – 10/19	9/13	9/01
10/20 – 12/31	11/25	11/15

The last quarter of the short tax year begins on October 20, which is 73 days from December 31, the end of the tax year. The 37th day of the last quarter is November 25, which is the midpoint of the quarter. November 25 is not the first day or the midpoint of November, so Tara Corporation must treat the property as placed in service in the middle of November (the nearest preceding first day or midpoint of that month).

Property Placed in Service in a Short Tax Year

To figure your MACRS depreciation deduction for the short tax year, you must first determine the depreciation for a full tax year. You do this by multiplying your basis in the property by the applicable depreciation rate. Then, determine the depreciation for the short tax year. Do this by multiplying the depreciation for a full tax year by a fraction. The numerator (top number) of the fraction is the number of months (including parts of a month) the property is treated as in service during the tax year (applying the applicable convention). The denominator (bottom number) is 12. See *Depreciation After a Short Tax Year*, later, for information on how to figure depreciation in later years.

Example 1—half-year convention.

Tara Corporation, with a short tax year beginning March 15 and ending December 31, placed in service on March 16 an item of 5-year property with a basis of $1,000. This is the only property the corporation placed in service during the short tax year. Tara does not elect to claim a section 179 deduction and the property does not qualify for a special depreciation allowance. The depreciation method for this property is the 200% declining balance method. The depreciation rate is 40% and Tara applies the half-year convention.

Tara treats the property as placed in service on
August 1. The determination of this August 1 date is explained in the example illustrating the half-year convention under *Using the Applicable Convention in a Short Tax Year*, earlier. Tara is allowed 5 months of depreciation for the short tax year that consists of 10 months. The corporation first multiplies the basis ($1,000) by 40% (the declining balance rate) to get the depreciation for a full tax year of $400. The corporation then multiplies $400 by $^{5}/_{12}$ to get the short tax year depreciation of $167.

Example 2—mid-quarter convention.

Tara Corporation, with a short tax year beginning March 15 and ending on December 31, placed in service on October 16 an item of 5-year property with a basis of $1,000. Tara does not elect to claim a section 179 deduction and the property does not qualify for a special depreciation allowance. The depreciation method for this property is the 200% declining balance method. The depreciation rate is 40%. The corporation must apply the mid-quarter convention because the property was the only item placed in service that year and it was placed in service in the last 3 months of the tax year.

Tara treats the property as placed in service on September 1. This date is shown in the table provided in the example illustrating the mid-quarter convention under *Using the Applicable Convention in a Short Tax Year*, earlier, for property that Tara Corporation placed in service during the quarter that begins on August 8 and ends on October 19. Under MACRS, Tara is allowed 4 months of depreciation for the short tax year that consists of 10 months. The corporation first multiplies the

basis ($1,000) by 40% to get the depreciation for a full tax year of $400. The corporation then multiplies $400 by $^{4}/_{12}$ to get the short tax year depreciation of $133.

Property Placed in Service Before a Short Tax Year

If you have a short tax year after the tax year in which you began depreciating property, you must change the way you figure depreciation for that property. If you were using the percentage tables, you can no longer use them. You must figure depreciation for the short tax year and each later tax year as explained next.

Depreciation After a Short Tax Year

You can use either of the following methods to figure the depreciation for years after a short tax year.

- The simplified method.
- The allocation method.

You must use the method you choose consistently.

Using the simplified method for a 12-month year. Under the simplified method, you figure the depreciation for a later 12-month year in the recovery period by multiplying the adjusted basis of your property at the beginning of the year by the applicable depreciation rate.

Example.

Assume the same facts as in *Example 1* under *Property Placed in Service in a Short Tax Year*, earlier. The Tara Corporation claimed depreciation of $167 for its short tax year. The adjusted basis on January 1 of the next year is $833 ($1,000 − $167). Tara's depreciation for that next year is 40% of $833, or $333.

Using the simplified method for a short year. If a later tax year in the recovery period is a short tax year, you figure depreciation for that year by multiplying the adjusted basis of the property at the beginning of the tax year by the applicable depreciation rate, and then by a fraction. The fraction's numerator is the number of months (including parts of a month) in the tax year. Its denominator is 12.

Using the simplified method for an early disposition. If you dispose of property in a later tax year before the end of the recovery period, determine the depreciation for the year of disposition by multiplying the adjusted basis of the property at the beginning of the tax year by the applicable depreciation rate and then multiplying the result by a fraction. The fraction's numerator is the number of months (including parts of a month) the property is treated as in service during the tax year (applying the applicable convention). Its denominator is 12.

Using the allocation method for a 12-month or short tax year. Under the allocation method, you figure the depreciation for each later tax year by allocating to that year the depreciation attributable to the parts of the recovery years that fall within that year. Whether your tax year is a 12-month or short tax year, you figure the depreciation by determining which recovery years are included in that year. For each recovery year included, multiply the depreciation attributable to that recovery year by a fraction. The fraction's numerator is the number of months (including parts of a month) that are included in both the tax year and the recovery year. Its denominator is 12. The allowable depreciation for the tax year is the sum of the depreciation figured for each recovery year.

Example.

Assume the same facts as in *Example 1* under *Property Placed in Service in a Short Tax Year*, earlier. The Tara Corporation's first tax year after the short tax year is a full year of 12 months, beginning January 1 and ending December 31. The first recovery year for the 5-year property placed in service during the short tax year extends from August 1 to July 31. Tara deducted 5 months of the first recovery year on its short-year tax return. Seven months of the first recovery year and 5 months of the second recovery year fall within the next tax year. The depreciation for the next tax year is $333, which is the sum of the following.

- $233—The depreciation for the first recovery year ($400 × $^{7}/_{12}$).
- $100—The depreciation for the second recovery year. This is figured by multiplying the adjusted basis of $600 ($1,000 − $400) by 40%, then multiplying the $240 result by $^{5}/_{12}$.

Using the allocation method for an early disposition. If you dispose of property before the end of the recovery period in a later tax year, determine the depreciation for the year of disposition by multiplying the depreciation figured for each recovery year or part of a recovery year included in the tax year by a fraction. The numerator of the fraction is the number of months (including parts of months) the property is treated as in service in the tax year (applying the applicable convention). The denominator is 12. If there is more than one recovery year in the tax year, you add together the depreciation for each recovery year.

How Do You Use General Asset Accounts?

To make it easier to figure MACRS depreciation, you can group separate properties into one or more general asset accounts (GAAs). You then can depreciate all the properties in each account as a single item of property.

Property you cannot include. You cannot include property in a GAA if you use it in both a personal activity and a trade or business (or for the production of income) in the year in which you first place it in service. If property you included in a GAA is later used in a personal activity, see *Terminating GAA Treatment*, later.

Property generating foreign source income. For information on the GAA treatment of property that generates foreign source income, see sections 1.168(i)-1(f) of the regulations.

Change in use. Special rules apply to figuring depreciation for property in a GAA for which the use changes during the tax year. Examples include a change in use resulting in a shorter recovery period and/or more accelerated depreciation method or a change in use resulting in a longer recovery period and/or a less accelerated depreciation method. See sections 1.168(i)-1(h) and 1.168(i)-4 of the regulations.

Grouping Property

Each GAA must include only property you placed in service in the same year and that has the following in common.

- Asset class, if any.

- Recovery period.
- Depreciation method.
- Convention.

The following rules also apply when you establish a GAA.

- No asset class. Properties without an asset class, but with the same depreciation method, recovery period, and convention, can be grouped into the same GAA.
- Mid-quarter convention. Property subject to the mid-quarter convention can only be grouped into a GAA with property placed in service in the same quarter of the tax year.
- Mid-month convention. Property subject to the mid-month convention can only be grouped into a GAA with property placed in service in the same month of the tax year.
- Passenger automobiles. Passenger automobiles subject to the limits on passenger automobile depreciation must be grouped into a separate GAA.

Figuring Depreciation for a GAA

After you have set up a GAA, you generally figure the MACRS depreciation for it by using the applicable depreciation method, recovery period, and convention for the property in the GAA. For each GAA, record the depreciation allowance in a separate depreciation reserve account.

Example.

Make & Sell, a calendar-year corporation, set up a GAA for ten machines. The machines cost a total of $10,000 and were placed in service in June 2010. One of the machines cost $8,200 and the rest cost a total of $1,800. This GAA is depreciated under the 200% declining balance method with a 5-year recovery period and a half-year convention. Make & Sell did not claim the section 179 deduction on the machines and the machines did not qualify for a special depreciation allowance. The depreciation allowance for 2010 is $2,000 [($10,000 × 40%) ÷ 2]. As of January 1, 2011, the depreciation reserve account is $2,000.

Passenger automobiles. To figure depreciation on passenger automobiles in a GAA, apply the deduction limits discussed in chapter 5 under *Do the Passenger Automobile Limits Apply*. Multiply the amount determined using these limits by the number of automobiles originally included in the account, reduced by the total number of automobiles removed from the GAA as discussed in *Terminating GAA Treatment,* later.

Disposing of GAA Property

When you dispose of property included in a GAA, the following rules generally apply.

- Neither the unadjusted depreciable basis (defined later) nor the depreciation reserve account of the GAA is affected. You continue to depreciate the account as if the disposition had not occurred.
- The property is treated as having an adjusted basis of zero, so you cannot realize a loss on the disposition. If the property is transferred to a supplies, scrap, or similar account, its basis in that account is zero.
- Any amount realized on the disposition is treated as ordinary income, up to the limit discussed later under *Treatment of amount realized.*

However, these rules do not apply to any disposition described later under *Terminating GAA Treatment.*

Disposition. Property in a GAA is considered disposed of when you do any of the following.

- Permanently withdraw it from use in your trade or business or from the production of income.
- Transfer it to a supplies, scrap, or similar account.
- Sell, exchange, retire, physically abandon, or destroy it.

The retirement of a structural component of real property is not a disposition.

Treatment of amount realized. When you dispose of property in a GAA, you must recognize any amount realized from the disposition as ordinary income, up to a limit. The limit is:

1. The unadjusted depreciable basis of the GAA **plus**
2. Any expensed costs for property in the GAA that are subject to recapture as depreciation (not including any expensed costs for property that you removed from the GAA under the rules discussed later under *Terminating GAA Treatment*), **minus**
3. Any amount previously recognized as ordinary income upon the disposition of other property from the GAA.

Unadjusted depreciable basis. The unadjusted depreciable basis of a GAA is the total of the unadjusted depreciable bases of all the property in the GAA. The unadjusted depreciable basis of an item of property in a GAA is the amount you would use to figure gain or loss on its sale, but figured without reducing your original basis by any depreciation allowed or allowable in earlier years. However, you do reduce your original basis by other amounts, including any amortization deduction, section 179 deduction, special depreciation allowance, and electric vehicle credit.

Expensed costs. Expensed costs that are subject to recapture as depreciation include the following.

1. The section 179 deduction.
2. Amortization deductions for the following.
   a. Pollution control facilities.
   b. Removal of barriers for the elderly and disabled.
   c. Tertiary injectants.
   d. Reforestation expenses.

Example 1.

The facts are the same as in the example under *Figuring Depreciation for a GAA,* earlier. In February 2011, Make & Sell sells the machine that cost $8,200 to an unrelated person for $9,000. The machine is treated as having an adjusted basis of zero.

On its 2011 tax return, Make & Sell recognizes the $9,000 amount realized as ordinary income because it is not more than the GAA's unadjusted depreciable basis ($10,000) plus any expensed cost (for example, the section 179 deduction) for property in the GAA ($0), minus any amounts previously recognized as ordinary income because of dispositions of other property from the GAA ($0).

The unadjusted depreciable basis and depreciation reserve of the GAA are not affected by the sale of the machine. The depreciation allowance for the GAA in 2011 is $3,200 [($10,000 − $2,000) × 40%].

Example 2.

Assume the same facts as in *Example 1*. In June 2012, Make & Sell sells seven machines to an unrelated person for a total of $1,100. These machines are treated as having an adjusted basis of zero.

On its 2012 tax return, Make & Sell recognizes $1,000 as ordinary income. This is the GAA's unadjusted depreciable basis ($10,000) plus the expensed costs ($0), minus the amount previously recognized as ordinary income ($9,000). The remaining amount realized of $100 ($1,100 − $1,000) is section 1231 gain (discussed in chapter 3 of Publication 544).

The unadjusted depreciable basis and depreciation reserve of the GAA are not affected by the disposition of the machines. The depreciation allowance for the GAA in 2012 is $1,920 [($10,000 − $5,200) × 40%].

Terminating GAA Treatment

You must remove the following property from a GAA.

- Property you dispose of in a nonrecognition transaction or an abusive transaction.
- Property you dispose of in a qualifying disposition or in a disposition of all the property in the GAA, if you choose to terminate GAA treatment.
- Property you dispose of in a like-kind exchange or an involuntary conversion.
- Property you change to personal use.
- Property for which you must recapture any allowable credit or deduction, such as the investment credit, the credit for qualified electric vehicles, the section 179 deduction, or the deduction for clean-fuel vehicles and clean-fuel vehicle refueling property placed in service before January 1, 2006.

If you remove property from a GAA, you must make the following adjustments.

1. Reduce the unadjusted depreciable basis of the GAA by the unadjusted depreciable basis of the property as of the first day of the tax year in which the disposition, change in use, or recapture event occurs. You can use any reasonable method that is consistently applied to determine the unadjusted depreciable basis of the property you remove from a GAA.
2. Reduce the depreciation reserve account by the depreciation allowed or allowable for the property (computed in the same way as computed for the GAA) as of the end of the tax year immediately preceding the year in which the disposition, change in use, or recapture event occurs.

These adjustments have no effect on the recognition and character of prior dispositions subject to the rules discussed earlier under *Disposing of GAA Property*.

Nonrecognition transactions. If you dispose of GAA property in a nonrecognition transaction, you must remove it from the GAA. The following are nonrecognition transactions.

- The receipt by one corporation of property distributed in complete liquidation of another corporation.
- The transfer of property to a corporation solely in exchange for stock in that corporation if the transferor is in control of the corporation immediately after the exchange.
- The transfer of property by a corporation that is a party to a reorganization in exchange solely for stock and securities in another corporation that is also a party to the reorganization.
- The contribution of property to a partnership in exchange for an interest in the partnership.
- The distribution of property (including money) from a partnership to a partner.
- Any transaction between members of the same affiliated group during any year for which the group makes a consolidated return.

Rules for recipient (transferee). The recipient of the property (the person to whom it is transferred) must include your (the transferor's) adjusted basis in the property in a GAA. If you transferred either all of the property or the last item of property in a GAA, the recipient's basis in the property is the result of the following.

- The adjusted depreciable basis of the GAA as of the beginning of your tax year in which the transaction takes place, **minus**
- The depreciation allowable to you for the year of the transfer.

For this purpose, the adjusted depreciable basis of a GAA is the unadjusted depreciable basis of the GAA minus any depreciation allowed or allowable for the GAA.

Abusive transactions. If you dispose of GAA property in an abusive transaction, you must remove it from the GAA. A disposition is an abusive transaction if it is not a nonrecognition transaction (described earlier) or a like-kind exchange or involuntary conversion and a main purpose for the disposition is to get a tax benefit or a result that would not be available without the use of a GAA. Examples of abusive transactions include the following.

1. A transaction with a main purpose of shifting income or deductions among taxpayers in a way that would not be possible without choosing to use a GAA to take advantage of differing effective tax rates.
2. A choice to use a GAA with a main purpose of disposing of property from the GAA so that you can use an expiring net operating loss or credit. For example, if you have a net operating loss carryover or a credit carryover, the following transactions will be considered abusive transactions unless there is strong evidence to the contrary.
    a. A transfer of GAA property to a related person.

b. A transfer of GAA property under an agreement where the property continues to be used, or is available for use, by you.

Figuring gain or loss. You must determine the gain, loss, or other deduction due to an abusive transaction by taking into account the property's adjusted basis. The adjusted basis of the property at the time of the disposition is the result of the following:

- The unadjusted depreciable basis of the property, **minus**
- The depreciation allowed or allowable for the property figured by using the depreciation method, recovery period, and convention that applied to the GAA in which the property was included.

If there is a gain, the amount subject to recapture as ordinary income is the smaller of the following.

1. The depreciation allowed or allowable for the property, including any expensed cost (such as section 179 deductions or the additional depreciation allowed or allowable for the property).
2. The result of the following:
   a. The original unadjusted depreciable basis of the GAA (plus, for section 1245 property originally included in the GAA, any expensed cost), **minus**
   b. The total gain previously recognized as ordinary income on the disposition of property from the GAA.

Qualifying dispositions. If you dispose of GAA property in a qualifying disposition, you can choose to remove the property from the GAA. A qualifying disposition is one that does not involve all the property, or the last item of property, remaining in a GAA and that is described by any of the following.

1. A disposition that is a direct result of fire, storm, shipwreck, other casualty, or theft.
2. A charitable contribution for which a deduction is allowed.
3. A disposition that is 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).
4. A nontaxable transaction other than a nonrecognition transaction (described earlier), a like-kind exchange or involuntary conversion, or a transaction that is nontaxable only because it is a disposition from a GAA.

If you choose to remove the property from the GAA, figure your gain, loss, or other deduction resulting from the disposition in the manner described earlier under *Abusive transactions*.

Like-kind exchanges and involuntary conversions. If you dispose of GAA property as a result of a like-kind exchange or involuntary conversion, you must remove from the GAA the property that you transferred. See chapter 1 of Publication 544 for information on these transactions. Figure your gain, loss, or other deduction resulting from the disposition in the manner described earlier under *Abusive transactions*.

Example.

Sankofa, a calendar-year corporation, maintains one GAA for 12 machines. Each machine costs $15,000 and was placed in service in 2009. Of the 12 machines, nine cost a total of $135,000 and are used in Sankofa's New York plant and three machines cost $45,000 and are used in Sankofa's New Jersey plant. Assume this GAA uses the 200% declining balance depreciation method, a 5-year recovery period, and a half-year convention. Sankofa does not claim the section 179 deduction and the machines do not qualify for a special depreciation allowance. As of January 1, 2011, the depreciation reserve account for the GAA is $93,600.

In May 2011, Sankofa sells its entire manufacturing plant in New Jersey to an unrelated person. The sales proceeds allocated to each of the three machines at the New Jersey plant is $5,000. This transaction is a qualifying disposition, so Sankofa chooses to remove the three machines from the GAA and figure the gain, loss, or other deduction by taking into account their adjusted bases.

For Sankofa's 2011 return, the depreciation allowance for the GAA is figured as follows. As of December 31, 2010, the depreciation allowed or allowable for the three machines at the New Jersey plant is $23,400. As of January 1, 2011, the unadjusted depreciable basis of the GAA is reduced from $180,000 to $135,000 ($180,000 minus the $45,000 unadjusted depreciable bases of the three machines), and the depreciation reserve account is decreased from $93,600 to $70,200 ($93,600 minus $23,400 depreciation allowed or allowable for the three machines as of December 31, 2010). The depreciation allowance for the GAA in 2011 is $25,920 [($135,000 − $70,200) × 40%].

For Sankofa's 2011 return, gain or loss for each of the three machines at the New Jersey plant is determined as follows. The depreciation allowed or allowable in 2011 for each machine is $1,440 [(($15,000 − $7,800) × 40%) ÷ 2]. The adjusted basis of each machine is $5,760 (the adjusted depreciable basis of $7,200 removed from the account less the $1,440 depreciation allowed or allowable in 2011). As a result, the loss recognized in 2011 for each machine is $760 ($5,000 − $5,760). This loss is subject to section 1231 treatment. See chapter 3 of Publication 544 for information on section 1231 losses.

Disposition of all property in a GAA. If you dispose of all the property, or the last item of property, in a GAA, you can choose to end the GAA. If you make this choice, you figure the gain or loss by comparing the adjusted depreciable basis of the GAA with the amount realized.

If there is a gain, the amount subject to recapture as ordinary income is limited to the result of the following.

- The depreciation allowed or allowable for the GAA, including any expensed cost (such as section 179 deductions or the additional depreciation allowed or allowable for the GAA), **minus**
- The total gain previously recognized as ordinary income on the disposition of property from the GAA.

Like-kind exchanges and involuntary conversions. If you dispose of all the property or the last item of property in a GAA as a result of a like-kind exchange or involuntary conversion, the GAA terminates. You must figure the gain or loss in the manner described above under *Disposition of all property in a GAA*.

Example.

Duforcelf, a calendar-year corporation, maintains a GAA for 1,000 calculators that cost a total of $60,000 and were placed in service in 2008. Assume this GAA is depreciated under the 200% declining balance method, has a recovery period of 5 years, and uses a half-year convention. Duforcelf does not claim the section 179 deduction and the calculators do not qualify for a special depreciation allowance. In 2010, Duforcelf sells 200 of the calculators to an unrelated person for $10,000. The $10,000 is recognized as ordinary income.

In March 2011, Duforcelf sells the remaining calculators in the GAA to an unrelated person for $35,000. Duforcelf decides to end the GAA.

On the date of the disposition, the adjusted depreciable basis of the account is $23,040 (unadjusted depreciable basis of $60,000 minus the depreciation allowed or allowable of $36,960). In 2011, Duforcelf recognizes a gain of $11,960. This is the amount realized of $35,000 minus the adjusted depreciable basis of $23,040. The gain subject to recapture as ordinary income is limited to the depreciation allowed or allowable minus the amounts previously recognized as ordinary income ($36,960 − $10,000 = $26,960). Therefore, the entire gain of $11,960 is recaptured as ordinary income.

Electing To Use a GAA

An election to include property in a GAA is made separately by each owner of the property. This means that an election to include property in a GAA must be made by each member of a consolidated group and at the partnership or S corporation level (and not by each partner or shareholder separately).

How to make the election. Make the election by completing line 18 of Form 4562.

When to make the election. You must make the election on a timely filed tax return (including extensions) for the year in which you place in service the property included in the GAA. However, if you timely filed your return for the year without making the election, you still can make the election by filing an amended return within 6 months of the due date of the return (excluding extensions). Attach the election to the amended return and write “Filed pursuant to section 301.9100-2” on the election statement.

You must maintain records that identify the property included in each GAA, that establish the unadjusted depreciable basis and depreciation reserve of the GAA, and that reflect the amount realized during the year upon dispositions from each GAA. However, see chapter 2 for the recordkeeping requirements for section 179 property.

Revoking an election. You can revoke an election to use a GAA only in the following situations.

- You include in the GAA property that generates foreign source income, both United States and foreign source income, or combined gross income of an FSC, a DISC, or a possessions corporation and its related supplier, and that inclusion results in a substantial distortion of income.
- You remove property from the GAA as described under *Terminating GAA Treatment*, earlier.

When Do You Recapture MACRS Depreciation?

When you dispose of property that you depreciated using MACRS, any gain on the disposition generally is recaptured (included in income) as ordinary income up to the amount of the depreciation previously allowed or allowable for the property. Depreciation, for this purpose, includes the following.

- Any section 179 deduction claimed on the property.
- Any deduction under section 179B of the Internal Revenue Code for capital costs to comply with Environmental Protection Agency sulfur regulations.
- Any deduction under section 179C of the Internal Revenue Code for certain qualified refinery property placed in service after August 8, 2005.
- Any deduction under section 179D of the Internal Revenue Code for certain energy efficient commercial building property placed in service after December 31, 2005.
- Any deduction under section 179E of the Internal Revenue Code for qualified advanced mine safety equipment property placed in service after December 20, 2006.
- Any deduction under section 190 of the Internal Revenue Code for removal of barriers to the disabled and the elderly.
- Any deduction under section 193 of the Internal Revenue Code for tertiary injectants.
- Any special depreciation allowance previously allowed or allowable for the property (unless you elected not to claim it).

There is no recapture for residential rental and nonresidential real property unless that property is qualified property for which you claimed a special depreciation allowance. For more information on depreciation recapture, see Publication 544.

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