

**§ 1.168(d)-0**

2143) and subject to section 168, except for property excluded from the application of section 168 as a result of section 168(f) or as a result of a transitional rule.

(3) *Unadjusted depreciable basis* is the basis of property for purposes of section 1011 without regard to any adjustments described in section 1016(a)(2) and (3). This basis reflects the reduction in basis for the percentage of the taxpayer's use of property for the taxable year other than in the taxpayer's trade or business (or for the production of income), for any portion of the basis the taxpayer properly elects to treat as an expense under section 179, and for any adjustments to basis provided by other provisions of the Internal Revenue Code and the regulations under the Code (other than section 1016(a)(2) and (3)) (for example, a reduction in basis by the amount of the disabled access credit pursuant to section 44(d)(7)). For property subject to a lease, see section 167(c)(2).

(4) *Adjusted depreciable basis* is the unadjusted depreciable basis of the property, as defined in § 1.168(b)-1T(a)(3), less the adjustments described in section 1016(a)(2) and (3).

(b) *Effective date.* (1) This section is applicable on February 27, 2004.

(2) The applicability of this section expires on or before February 27, 2007.

[T.D. 9115, 69 FR 9533, Mar. 1, 2004]

**§ 1.168(d)-0 Table of contents for the applicable convention rules.**

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

*§ 1.168(d)-1 Applicable conventions—Half-year and mid-quarter conventions.*

- (a) In general.
- (b) Additional rules for determining whether the mid-quarter convention applies and for applying the applicable convention.
  - (1) Property described in section 168(f).
  - (2) Listed property.
  - (3) Property placed in service and disposed of in the same taxable year.
  - (4) Aggregate basis of property.
  - (5) Special rules for affiliated groups.
  - (6) Special rule for partnerships and S corporations.
  - (7) Certain nonrecognition transactions.
- (c) Disposition of property subject to the half-year or mid-quarter convention.
  - (1) In general.
  - (2) Example.

(d) Effective date.

[T.D. 8444, 57 FR 48981, Oct. 29, 1992]

**§ 1.168(d)-1 Applicable convention—Half-year and mid-quarter conventions.**

(a) *In general.* Under section 168(d), the half-year convention applies to depreciable property (other than certain real property described in section 168(d)(2)) placed in service during a taxable year, unless the mid-quarter convention applies to the property. Under section 168(d)(3)(A), the mid-quarter convention applies to depreciable property (other than certain real property described in section 168(d)(2)) placed in service during a taxable year if the aggregate basis of property placed in service during the last three months of the taxable year exceeds 40 percent of the aggregate basis of property placed in service during the taxable year (“the 40-percent test”). Thus, if the depreciable property is placed in service during a taxable year that consists of three months or less, the mid-quarter convention applies to the property. Under section 168(d)(3)(b)(i), the depreciable basis of nonresidential real property, residential rental property, and any railroad grading or tunnel bore is disregarded in applying the 40-percent test. For rules regarding property that is placed in service and disposed of in the same taxable year, see paragraph (b)(3) of this section. For the definition of “aggregate basis of property,” see paragraph (b)(4) if this section.

(b) *Additional rules for determining whether the mid-quarter convention applies and for applying the applicable convention—*(1) *Property described in section 168(f).* In determining whether the 40-percent test is testified for a taxable year, the depreciable basis of property described in section 168(f) (property to which section 168 does not apply) is not taken into account.

(2) *Listed property.* The depreciable basis of listed property (as defined in section 280F(d)(4) and the regulations thereunder) placed in service during a taxable year is taken into account (unless otherwise excluded) in applying the 40-percent test.

(3) *Property placed in service and disposed of in the same taxable year.* (i)

and (ii) [Reserved] For further guidance, see § 1.168(d)-1T(b)(3)(i) and (ii).

(4) *Aggregate basis of property.* For purposes of the 40-percent test, the term “aggregate basis of property” means the sum of the depreciable bases of all items of depreciable property that are taken into account in applying the 40-percent test. “Depreciable basis” means the basis of depreciable property for purposes of determining gain under sections 1011 through 1024. The depreciable basis for the taxable year the property is placed in service reflects the reduction in basis for—

(i) Any portion of the basis the taxpayer properly elects to treat as an expense under section 179;

(ii) Any adjustment to basis under section 48(q); and

(iii) The percentage of the taxpayer’s use of the property for the taxable year other than in the taxpayer’s trade or business (or for the production of income), but is determined before any reduction for depreciation under section 167(a) for that taxable year.

(5) *Special rules for affiliated groups—*

(i) In the case of a consolidated group (as defined in § 1.1502-1(h)), all members of the group that are included on the consolidated return are treated as one taxpayer for purposes of applying the 40-percent test. Thus, the depreciable bases of all property placed in service by members of a consolidated group during a consolidated return year are taken into account (unless otherwise excluded) in applying the 40-percent test to determine whether the mid-quarter convention applies to property placed in service by the members during the consolidated return year. The 40-percent test is applied separately to the depreciable bases of property placed in service by any member of an affiliated group that is not included in a consolidated return of the taxable year in which the property is placed in service.

(ii) In the case of a corporation formed by a member or members of a consolidated group and that is itself a member of the consolidated group (“newly-formed subsidiary”), the depreciable bases of property placed in service by the newly-formed subsidiary in the consolidated return year in which it is formed is included with the

depreciable bases of property placed in service during the consolidated return year by the other members of the consolidated group in applying the 40-percent test. If depreciable property is placed in service by a newly-formed subsidiary during the consolidated return year in which it was formed, the newly-formed subsidiary is considered as being in existence for the entire consolidated return year for purposes of applying the applicable convention to determine when the recovery period begins.

(iii) The provisions of paragraph (b)(5)(ii) of this section are illustrated by the following example.

*Example.* Assume a member of a consolidated group that files its return on a calendar-year basis forms a subsidiary on August 1. The subsidiary places depreciable property in service on August 5. If the mid-quarter convention applies to property placed in service by the members of the consolidated group (including the newly-formed subsidiary), the property placed in service by the subsidiary on August 5 is deemed placed in service on the mid-point of the third quarter of the consolidated return year (*i.e.*, August 15). If the mid-quarter convention does not apply, the property is deemed placed in service on the mid-point of the consolidated return year (*i.e.*, July 1).

(iv) In the case of a corporation that joins or leaves a consolidated group, the depreciable bases of property placed in service by the corporation joining or leaving the group during the portion of the consolidated return year that the corporation is a member of the consolidated group is included with the depreciable bases of property placed in service during the consolidated return year by the other members in applying the 40-percent test. The depreciable bases of property placed in service by the joining or leaving member in the taxable year before it joins or after it leaves the consolidated group is not taken into account by the consolidated group in applying the 40-percent test for the consolidated return year. If a corporation leaves a consolidated group and joins another consolidated group, each consolidated group takes into account, in applying the 40-percent test, the depreciable bases of property placed in service by the corporation while a member of the group.

(v) The provisions of paragraph (b)(5)(iv) of this section are illustrated by the following example.

*Example.* Assume Corporations A and B file a consolidated return on a calendar-year basis. Corporation C, also a calendar-year taxpayer, enters the consolidated group on July 1 and is included on the consolidated return for that taxable year. The depreciable bases of property placed in service by C during the period of July 1 to December 31 is included with the depreciable bases of property placed in service by A and B during the entire consolidated return year in applying the 40-percent test. The depreciable bases of property placed in service by C from January 1 to June 30 is not taken into account by the consolidated group in applying the 40-percent test. If C was a member of another consolidated group during the period from January 1 to June 30, that consolidated group would include the depreciable bases of property placed in service by C during that period.

(vi) A corporation that joins or leaves a consolidated group during a consolidated year is considered as being a member of the consolidated group for the entire consolidated return year for purposes of applying the applicable convention to determine when the recovery period begins for depreciable property placed in service by the corporation during the portion of the consolidated return year that the corporation is a member of the group.

(vii) If depreciable property is placed in service by a corporation in the taxable year ending immediately before it joins a consolidated group or beginning immediately after it leaves a consolidated group, the applicable convention is applied to the property under either the full taxable year rules or the short taxable year rules, as applicable.

(viii) The provisions of paragraphs (d)(5)(vi) and (vii) of this section are illustrated by the following example.

*Example.* Assume that on July 1, C, a calendar-return corporation, joins a consolidated group that files a return on a calendar-year basis. The short taxable year rules apply to C for the period of January 1 to June 30. However, in applying the applicable convention to determine when the recovery period begins for depreciable property placed in service for the period of July 1 to December 31, C is considered as being a member of the consolidated group for the entire consolidated return year. Thus, if the half-year convention applies to depreciable property placed in service by the consolidated group

(taking into account the depreciable bases of property placed in service by C after June 30), the property is deemed placed in service on the mid-point of the consolidated return year (*i.e.*, July 1, if the group did not have a short taxable year).

(ix) In the case of a transfer of depreciable property between members of a consolidated group, the following special rules apply for purposes of applying the 40-percent test. Property that is placed in service by one member of a consolidated group and transferred to another member of the same group is considered as placed in service on the date that it is placed in service by the transferor member, and the date it is placed in service by the transferee member is disregarded. In the case of multiple transfers of property between members of a consolidated group, the property is considered as placed in service on the date that the first member places the property in service, and the dates it is placed in service by other members are disregarded. The depreciable basis of the transferred property that is taken into account in applying the 40-percent test is the depreciable basis of the property in the hands of the transferor member (as determined under paragraph (b)(4) of this section), or, in the case of multiple transfers of property between members, the depreciable basis in the hands of the first member that placed the property in service.

(x) The provisions of paragraph (b)(5)(ix) of this section are illustrated by the following example.

*Example.* Assume the ABC consolidated group files its return on a calendar-year basis. A, a member of the consolidated group, purchases depreciable property costing \$50,000 and places the property in service on January 5, 1991. On December 1, 1991, the property is transferred for \$75,000 to B, another member of the consolidated group. In applying the 40-percent test to the members of the consolidated group for 1991, the property is considered as placed in service on January 5, the date that A placed the property in service, and the depreciable basis of the property that is taken into account is \$50,000.

(6) *Special rule for partnerships and S corporations.* In the case of property placed in service by a partnership or an S corporation, the 40-percent test is generally applied at the partnership or

corporate level. However, if a partnership or an S corporation is formed or availed of for the principal purpose of either avoiding the application of the mid-quarter convention or having the mid-quarter convention apply where it otherwise would not, the 40-percent test is applied at the partner, shareholder, or other appropriate level.

(7) *Certain nonrecognition transaction*—(i) Except as provided in paragraph (b)(6) of this section, if depreciable property is transferred in a transaction described in section 168(i)(7)(B)(i) (other than in a transaction between members of a consolidated group) in the same taxable year that the property is placed in service by the transferor, the 40-percent test is applied by treating the transferred property as placed in service by the transferee on the date of transfer. Thus, if the aggregate basis of property (including the transferred property) placed in service by the transferee during the last three months of its taxable year exceeds 40 percent of the aggregate basis of property (including the transferred property) placed in service by the transferee during the taxable year, the mid-quarter convention applies to the transferee's depreciable property, including the transferred property. The depreciable basis of the transferred property is not taken into account by the transferor in applying the 40-percent test for the taxable year that the transferor placed the property in service.

(ii) In applying the applicable convention to determine when the recovery period for the transferred property begins, the date on which the transferor placed the property in service must be used. Thus, for example, if the mid-quarter convention applies, the recovery period for the transferred property begins on the mid-point of the quarter of the taxable year that the transferor placed the property in service. If the transferor placed the transferred property in service in a short taxable year, then for purposes of applying the applicable convention and allocating the depreciation deduction between the transferor and the transferee, the transferor is treated as having a full 12-month taxable year commencing on the first day of the short

taxable year. The depreciation deduction for the transferor's taxable year in which the property was placed in service is allocated between the transferor and the transferee based on the number of months in the transferor's taxable year that each party held the property in service. For purposes of allocating the depreciation deduction, the transferor takes into account the month in which the property was placed in service but does not take into account the month in which the property was transferred. The transferee is allocated the remaining portion of the depreciation deduction for the transferor's taxable year in which the property was transferred. For the remainder of the transferee's current taxable year (if the transferee has a different taxable year than the transferor) and for subsequent taxable years, the depreciation deduction for the transferee is calculated by allocating to the transferee's taxable year the depreciation attributable to each recovery year, or portion thereof, that falls within the transferee's taxable year.

(iii) If the applicable convention for the transferred property has not been determined by the time the transferor files its income tax return for the year of transfer because the transferee's taxable year has not ended, the transferor may use either the mid-quarter or the half-year convention in determining the depreciation deduction for the property. However, the transferor must specify on the depreciation form filed for the taxable year that the applicable convention has not been determined for the property. If the transferee determines that a different convention applies to the transferred property, the transferor should redetermine the depreciation deduction on the property, and, within the period of limitation, should file an amended income tax return for the taxable year and pay any additional tax due plus interest.

(iv) The provisions of the paragraph (b)(7) are illustrated by the following example.

*Example.* (i) During 1991, C, a calendar-year taxpayer, purchases satellite equipment costing \$100,000, and computer equipment costing \$15,000. The satellite equipment is placed in service in January, and the computer equipment in February. On October 1,

## § 1.168(d)-1T

## 26 CFR Ch. I (4-1-04 Edition)

C transfers the computer equipment to Z Partnership in a transaction described in section 721. During 1991, Z, a calendar-year partnership, purchases 30 office desks for a total of \$15,000. The desks are placed in service in June. These are the only items of depreciable property placed in service by C and Z during 1991.

(ii) In applying the 40-percent test, because C transferred the computer equipment in a transaction described in section 168(i)(7)(B)(i) in the same taxable year that C placed it in service, the computer equipment is treated as placed in service by the transferee, Z, on the date of transfer, October 1. The 40-percent test is satisfied with respect to Z, because the computer equipment is placed in service during the last three months of Z's taxable year and its basis (\$15,000) exceeds 40 percent of the aggregate basis of property placed in service by Z during the taxable year (desks and computer equipment with an aggregate basis of \$30,000).

(iii) In applying the mid-quarter convention to determine when the computer equipment is deemed to be placed in service, the date on which C placed the property in service is used. Accordingly, because C placed the computer equipment in service during the first quarter of its taxable year, the computer equipment is deemed placed in service on February 15, 1991, the mid-point of the first quarter of C's taxable year. The depreciation deduction allowable for C's 1991 taxable year, \$5,250 ( $\$15,000 \times 40 \text{ percent} \times 10.5/12$ ), is allocated between C and Z based on the number of months in C's taxable year that C and Z held the property in service. Thus, because the property was in service for 11 months during C's 1991 taxable year and C held it for 8 of those 11 months, C is allocated \$3,818 ( $8/11 \times \$5,250$ ). Z is allocated \$1,432, the remaining  $3/11$  of the \$5,250 depreciation deduction for C's 1991 taxable year. For 1992, Z's depreciation deduction for the computer equipment is \$3,900, the sum of the remaining 1.5 months of depreciation deduction for the first recovery year and 10.5 months of depreciation deduction for the second recovery year ( $(\$15,000 \times 40 \text{ percent} \times 1.5/12) + (\$9,000 \times 40 \text{ percent} \times 10.5/12)$ ).

(c) *Disposition of property subject to the half-year or mid-quarter convention—(1) In general.* If depreciable property is subject to the half-year (or mid-quarter) convention in the taxable year in which it is placed in service, it also is subject to the half-year (or mid-quarter) convention in the taxable year in which it is disposed of.

(2) *Example.* The provisions of paragraph (c)(1) of this section are illustrated by the following example.

*Example.* In October 1991, B, a calendar-year taxpayer, purchases and places in service a light general purpose truck costing \$10,000. B does not elect to expense any part of the cost of the truck, and this is the only item of depreciable property placed in service by B during 1991. The 40-percent test is satisfied and the mid-quarter convention applies, because the truck is placed in service during the last three months of the taxable year and no other assets are placed in service in that year. In April 1993 (prior to the end of the truck's recovery period), B sells the truck. The mid-quarter convention applies in determining the depreciation deduction for the truck in 1993, the year of disposition.

(d) *Effective dates—(1) In general.* This section applies to depreciable property placed in service in taxable years ending after January 30, 1991. For depreciable property placed in service after December 31, 1986, in taxable years ending on or before January 30, 1991, a taxpayer may use a method other than the method provided in this section in applying the 40-percent test and the applicable convention, provided the method is reasonable and is consistently applied to the taxpayer's property.

(2) *Qualified property, 50-percent bonus depreciation property, or qualified New York Liberty Zone property.* [Reserved]. For further guidance, see § 1.168(d)-1T(d).

(3) *Like-kind exchanges and involuntary conversions.* [Reserved] For further guidance, see § 1.168(d)-1T(d)(3)(i).

[T.D. 8444, 57 FR 48981, Oct. 29, 1992, as amended by T.D. 9091, 68 FR 52991, Sept. 8, 2003; T.D. 9115, 69 FR 9533, Mar. 1, 2004]

### § 1.168(d)-1T Applicable conventions—Half-year and mid-quarter conventions (temporary).

(a) through (b)(2) [Reserved]. For further guidance, see § 1.168(d)-1(a) through (b)(2).

(b)(3) *Property placed in service and disposed of in the same taxable year—(i) Under section 168(d)(3)(B)(ii), the depreciable basis of property placed in service and disposed of in the same taxable year is not taken into account in determining whether the 40-percent test is satisfied. However, the depreciable basis of property placed in service, disposed of, subsequently reacquired, and again placed in service, by the taxpayer in the same taxable year must be*