

Chapter 1: Depreciation

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Please note. Corrections were made to this workbook through January of 2016. No subsequent modifications were made. For clarification about acronyms used throughout this chapter, see the Acronym Glossary at the end of the Index.

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NEW LEGISLATION

In late December 2014, Congress extended certain expiring provisions for the 2014 tax year. Unfortunately, the Tax Increase Prevention Act of 2014 (TIPA) extended these provisions only through December 31, 2014. Therefore, Congress must act to extend the provisions for future tax years.

TIPA's business extenders include the following depreciation provisions.

- 50% bonus depreciation.**¹ Taxpayers may claim bonus depreciation for qualified new property placed in service prior to January 1, 2015 (January 1, 2016, for certain property with a longer production period and certain aircraft).
- Election to accelerate the alternative minimum tax (AMT) credit in lieu of bonus depreciation.**² This election applies only to corporate taxpayers and AMT credits arising prior to 2006.
- Higher limitations for the IRC §179 deduction.**³ The 2014 IRC §179 deduction limit is \$500,000, and the overall investment limit is \$2 million. The deduction and the investment limits revert to \$25,000 and \$200,000, respectively, for 2015 unless Congress acts to change them.
- Treatment of certain real property as IRC §179 property.**⁴ For 2014, §179 property includes qualified leasehold improvement property, qualified restaurant property, and qualified retail improvement property. However, the maximum §179 deduction for these types of property is \$250,000. If the §179 deduction of these types of assets is limited by the taxpayer's income, the excess may not be carried over to tax years beginning after December 31, 2014.⁵ Unless modified by Congress, these assets will no longer qualify for the §179 deduction for tax years beginning after 2014.

¹ IRC §168(k).

² IRC §168(k)(4)(E)(iv).

³ IRC §179(b)(1).

⁴ IRC §179(f)(1).

⁵ IRC §179(f)(4).

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- 5. 15-year straight-line cost recovery for certain real property.** For 2014, 15-year property includes qualified leasehold improvements, qualified restaurant buildings and improvements, and qualified retail improvements.⁶

The following table summarizes the depreciation rules as modified by TIPA for qualified real property.

	Leasehold Improvements	Restaurant Buildings and Improvements	Retail Improvements
15-year depreciable life	Yes, if placed in service before 2015	Yes, if placed in service before 2015	Yes, if placed in service before 2015
Bonus depreciation	Yes, if placed in service before 2015 and lease is between unrelated parties	No	No
Section 179 (limited to \$250,000)	Yes, if placed in service before 2015	Yes, if placed in service before 2015	Yes, if placed in service before 2015

- 6. Classification of certain race horses as 3-year property.**⁷ For 2014, 3-year property includes all racehorses.
- 7. The 7-year recovery period for motorsports entertainment complexes.**⁸ The accelerated recovery period for motorsports entertainment complexes was in effect through December 31, 2014.
- 8. Accelerated depreciation for business property on an Indian reservation.**⁹ The accelerated recovery period for qualified Indian reservation property was in effect through December 31, 2014.
- 9. Election to expense mine safety equipment.**¹⁰
- 10. Special expensing rules for certain film and television productions.**¹¹

⁶ IRC §168(e)(3)(E).

⁷ IRC §168(e)(3)(A)(i).

⁸ IRC §168(i)(15)(D).

⁹ IRC §168(j)(8).

¹⁰ IRC §179E(g).

¹¹ IRC §181(f).

REVIEW OF THE BASICS

Note. For comprehensive explanations of depreciation methods, see the 2011 *University of Illinois Federal Tax Fundamentals*, Chapter 4: Depreciation Basics; and the 2011 *University of Illinois Federal Tax Workbook*, Chapter 1: Depreciation. These chapters can be found at **uofi.tax/arc** [www.taxschool.illinois.edu/taxbookarchive].

NINE PROPERTY CLASSES

Under the general depreciation system (GDS), there are nine property classifications. Those classifications and examples of the types of property included in each one are as follows.¹²

1. 3-year property

- a. Tractor units for over-the-road use
- b. Any racehorse over two years old when placed in service (All racehorses placed in service after December 31, 2008, and before January 1, 2015, are deemed to be 3-year property, regardless of age.)
- c. Any other horse (other than a racehorse) over 12 years old when placed in service
- d. Qualified rent-to-own property

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, and other items 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, 2015
- e. Any natural gas gathering line placed in service after April 11, 2005

¹² IRS Pub. 946, *How To Depreciate Property*.

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 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, such as a convenience store
- c. Any municipal wastewater treatment plant
- d. Any qualified leasehold improvement property placed in service before January 1, 2015
- e. Any qualified restaurant property placed in service before January 1, 2015
- f. Initial clearing and grading land improvements for gas utility property
- g. Electric transmission property (that is IRC §1245 property) used in the transmission at 69 or more kilovolts of electricity placed in service after April 11, 2005
- h. Any natural gas distribution line placed in service after April 11, 2005, and before January 1, 2011
- i. Any qualified retail improvement property placed in service before January 1, 2015

6. 20-year property

- a. Farm buildings (other than single-purpose agricultural and 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 is water utility property.

8. Residential rental property (27.5 years). 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 in which more than half the units are used on a transient basis. If the taxpayer occupies any part of the building or structure for personal use, its gross rental income includes the fair rental value of the part occupied by the taxpayer.

9. Nonresidential real property (39 years). This is IRC §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.

APPENDIX B OF IRS PUB. 946

The Code specifically includes certain types of depreciable property in each of the preceding nine classes. However, the IRS is responsible for determining the recovery period for assets not included in those classes. To assist taxpayers and practitioners in properly classifying various types of property, the IRS publishes more detailed lists in appendix B of IRS Pub. 946, *How To Depreciate Property*.

The assets covered in appendix B do not include real property unless the description specifically mentions **section 1250 property**. For example, table B-2, class 15, covers construction assets. The description for this class does not include the phrase “section 1250 property.” The “construction” category does not have any subcategories that might include this phrase. Therefore, the list of nine classes is used to determine the class life for real property used in a construction activity.

Table B-1 generally lists assets used in **all** business activities. Table B-2 describes assets used only in **certain** activities.

Both tables are used to determine the correct recovery period for an asset. The user must first look at table B-1 for a description of the property. However, even if the asset is listed in table B-1, the user must still review table B-2 to determine if the asset is assigned a different recovery life based on the activity for which it is used.

The introduction to appendix B explains this process in more detail. **Appendix B in its entirety is included at the end of this chapter so readers can refer to it.**

IRC §179 DEDUCTION¹³

For tax years beginning in 2015, the deduction and investment limits are \$25,000 and \$200,000, respectively, unless Congress acts to change them.

Property qualifying for the §179 deduction may be new or used. It must satisfy all the following requirements.

1. Eligible property
2. Acquired for business use
3. Acquired by purchase

Eligible Property

To qualify for the §179 deduction, the asset must be one of the following types of depreciable property.

1. Tangible personal property
2. Other tangible property (except buildings and their structural components) used in one of the following ways.
 - a. As an integral part of manufacturing, production, or extraction or of furnishing transportation, communications, electricity, gas, water, or sewage disposal services
 - b. As a research facility used in connection with any of the activities in item **a**
 - c. As a facility used in connection with any activities in item **a** for the bulk storage of fungible commodities
3. Single-purpose agricultural (livestock) or horticultural structures
4. Storage facilities (except buildings and their structural components) used in connection with distributing petroleum or any primary product of petroleum
5. Off-the-shelf computer software (for tax years beginning after 2002 and before 2015)

¹³ IRS Pub. 946, *How To Depreciate Property*.

6. The following types of qualified real property (for tax years beginning before 2015)
 - a. Qualified leasehold improvement property
 - b. Qualified restaurant property
 - c. Qualified retail improvement property

Property Acquired for Business Use

To qualify for the §179 deduction, the property must have been acquired for use in a trade or business. Property acquired only for the production of income — such as investment property, rental property (if renting property is not the taxpayer's trade or business), and property that produces royalties — does not qualify.

Partial Business Use. When property is used for both business and nonbusiness purposes, the taxpayer can elect the §179 deduction only if they use the property more than 50% for business in the year they place it in service. If the taxpayer uses the property more than 50% for business, the cost of the property is multiplied by the percentage of business use. The resulting business cost is used to calculate the §179 deduction.

Property Acquired by Purchase

To qualify for the §179 deduction, property must have been purchased. Property acquired by gift or inheritance does not qualify. Property is not considered to be acquired by purchase in the following situations.

1. It is acquired by one member of a controlled group from another member of the same group.
2. Its basis is determined in whole or in part by its adjusted basis in the hands of the person from whom it was acquired.
3. Its basis is determined under the stepped-up basis rules for property acquired from a decedent.
4. It is acquired from a related person.

BONUS DEPRECIATION¹⁴

Taxpayers could have claimed bonus depreciation for qualified new property placed in service after December 31, 2007, and prior to January 1, 2015 (January 1, 2016, for certain property with a longer production period and certain aircraft). To calculate bonus depreciation, the percentage shown in the following table is applied to the adjusted basis of the property.¹⁵

Placed in Service Date	Applicable Percentage
After December 31, 2007, and before September 9, 2010	50%
After September 8, 2010, and before January 1, 2011	100% or 50% ^a
After December 31, 2010, and before January 1, 2012	100%
After December 31, 2011, and before January 1, 2015	50%

^a Using the election under Rev. Proc. 2011-26.

The bonus depreciation allowance applies only for the first year that the property is placed in service. The allowance is taken after any §179 expense deduction and before the regular depreciation allowance under the modified accelerated cost recovery system (MACRS).

¹⁴ IRC §168(k).

¹⁵ IRC §§168(k)(1)(A) and (k)(5).

Qualifying property for purposes of first-year bonus depreciation must meet all the following requirements.

1. The property must be one of the following.
 - a. MACRS property with an applicable recovery period of 20 years or less
 - b. Water utility property (as defined in IRC §168(e)(5))
 - c. Computer software (other than software that is an IRC §197 intangible)
 - d. Qualified leasehold improvement property (as defined in §168(k)(3))
2. The original use of the property must commence with the taxpayer (must be new property).
3. The taxpayer must purchase the property after December 31, 2007, and before January 1, 2015.
4. The property must be placed in service before January 1, 2015. (An extension of one year is provided for certain property with a recovery period of 10 years or longer and certain transportation property.)

A taxpayer may **elect out** of bonus depreciation for one or more classes of property for any tax year.

LISTED PROPERTY¹⁶

Special depreciation rules apply to listed property. Listed property is any of the following.

1. Passenger automobiles weighing 6,000 pounds or less
2. Any other property used for transportation, unless it is one of the following excepted vehicles¹⁷
 - ♦ Clearly marked police and fire vehicles
 - ♦ Unmarked vehicles used by law enforcement officers if the use is officially authorized
 - ♦ Ambulances used as such and hearses used as such
 - ♦ Any vehicle with a loaded gross vehicle weight of more than 14,000 pounds that is designed to carry cargo
 - ♦ Bucket trucks (cherry pickers), cement mixers, dump trucks (including garbage trucks), flatbed trucks, and refrigerated trucks
 - ♦ Combines, cranes and derricks, and forklifts
 - ♦ Delivery trucks with seating only for the driver or only for the driver plus a folding jump seat
 - ♦ Qualified moving vans
 - ♦ Qualified specialized utility repair trucks
 - ♦ School buses used in transporting students and employees of schools
 - ♦ Other buses with a capacity of at least 20 passengers that are used as passenger buses
 - ♦ Tractors and other special-purpose farm vehicles
3. Property generally used for entertainment, recreation, or amusement (including photographic, phonographic, communication, and video-recording equipment)
4. Computers and related peripheral equipment, unless it is used only at a regular business establishment and owned or leased by the person operating the establishment (A regular business establishment includes a portion of a dwelling unit that is used both regularly and exclusively for business, as discussed in IRS Pub. 587, *Business Use of Your Home*.)

¹⁶ IRC §280F.

¹⁷ IRS Pub. 946, *How To Depreciate Property*.

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Listed property must be used predominantly (more than 50% of its total use) for **qualified business use** to qualify for any of the following.

1. §179 deduction
2. Bonus depreciation
3. Depreciation using the GDS
4. Declining balance method of calculating depreciation

Qualified business use of listed property is any use of the property in the taxpayer's trade or business. The following uses are not included, however.¹⁸

- The leasing of property to any 5% owner or related person (to the extent the property is used by a 5% owner or person related to the owner or lessee of the property)
- The use of property as payment for the services of a 5% owner or related person
- The use of property as payment for services of any person (other than a 5% owner or related person), unless the value of the use is included in that person's gross income and income tax is withheld on that amount when required

Note. Examples showing the application of these rules are provided later in this chapter.

If the listed property is not used predominantly for qualified business use, the following rules apply.

1. Any depreciation deduction under MACRS must be calculated using the straight-line method over the alternative depreciation system (ADS) recovery period. This rule applies each year of the recovery period.
2. Excess depreciation on property previously used predominantly for qualified business use must be recaptured in the first year in which it is no longer used predominantly for qualified business use.
3. A lessee must add an inclusion amount to income in the first year in which the leased property is not used predominantly for qualified business purposes. See IRS Pub. 463, *Travel, Entertainment, Gift, and Car Expenses*, and IRS Pub. 946 for calculating the inclusion amount.

¹⁸. Ibid.

Passenger Automobile Maximum Depreciation Deduction

The depreciation deduction, including the §179 deduction, that a taxpayer can claim for a passenger automobile each year is limited. The maximum depreciation amounts for most passenger automobiles are shown in the following table.¹⁹

**Maximum Depreciation Deduction
for Passenger Automobiles**

Date Placed In Service	1st Year	2nd Year	3rd Year	4th & Later Years
2014	\$11,160 ¹	\$5,100	\$3,050	\$1,875
2013	11,160 ¹	5,100	3,050	1,875
2012	11,160 ¹	5,100	3,050	1,875
2011	11,060 ²	4,900	2,950	1,775
2010	11,060 ²	4,900	2,950	1,775
2009	10,960 ³	4,800	2,850	1,775
2008	10,960 ³	4,800	2,850	1,775
2007	3,060	4,900	2,850	1,775
2006	2,960	4,800	2,850	1,775
2005	2,960	4,700	2,850	1,675
2004	10,610 ⁴	4,800	2,850	1,675

¹If you elected **not** to claim any special depreciation allowance or the vehicle is **not** qualified property, the maximum deduction is \$3,160.

²If you elected **not** to claim any special depreciation allowance or the vehicle is **not** qualified property, the maximum deduction is \$3,060.

³If you elected **not** to claim any special depreciation allowance for the vehicle or the vehicle is **not** qualified property, the maximum deduction is \$2,960.

⁴If you elected **not** to claim any special depreciation allowance for the vehicle, the vehicle is **not** qualified property, or the vehicle is qualified Liberty Zone property, the maximum deduction is \$2,960.



If your business/investment use of the automobile is less than 100%, you must reduce the maximum deduction amount by multiplying the maximum amount by the percentage of business/investment use determined on an annual basis during the tax year.



If you have a short tax year, you must reduce the maximum deduction amount by multiplying the maximum amount by a fraction. The numerator of the fraction is the number of months and partial months in the short tax year and the denominator is 12.

¹⁹ Ibid.

DEPRECIATION TRANSACTIONS INVOLVING RELATED PARTIES²⁰

Congress recognizes that related taxpayers can easily manipulate various tax provisions in ways that give them an unfair advantage over unrelated taxpayers. To address this situation, Congress has enacted a number of provisions that restrict the use of certain tax benefits between related parties. However, the term **related parties** is defined differently for various Code provisions. Practitioners must therefore be careful to use the right definition when determining the tax treatment of a specific transaction between parties who may or may not be deemed related.

GENERAL RULES

Defining Related Parties

The term **related parties** includes people and entities that have connections to the taxpayer as defined in IRC §267. The connections may be familial, or they may be created through an ownership interest in an entity.

For transactions involving property, related parties are **generally** defined as follows.

1. An individual and a member of their family, including only a spouse, child, parent, brother, sister, half-brother, half-sister, ancestor, and lineal descendant
2. A corporation and an individual who directly or indirectly owns more than 50% of the value of the corporation's outstanding stock
3. Two corporations that are members of the same controlled group
4. A trust fiduciary and a corporation, if more than 50% of the value of the outstanding stock is directly or indirectly owned by or for the trust or grantor of the trust
5. The grantor and the fiduciary, and the fiduciary and beneficiary, of any trust
6. The fiduciaries of two different trusts and the fiduciaries and the beneficiaries of two different trusts, if the same person is the grantor of both trusts
7. A tax-exempt educational or charitable organization and any person (or, if that person is an individual, a member of that person's family) who directly or indirectly controls the organization
8. Two S corporations, if the same persons own more than 50% of the value of each corporation's outstanding stock
9. An S corporation and a C corporation, if the same persons own more than 50% of the value of each corporation's outstanding stock
10. A corporation and a partnership, if the same persons own both of the following
 - a. More than 50% of the value of the corporation's outstanding stock
 - b. More than 50% of the capital or profits interest in the partnership
11. The executor and the beneficiary of any estate
12. A partnership and a person who directly or indirectly owns more than 50% of the partnership's capital or profits interest
13. Two partnerships, if the same persons directly or indirectly own more than 50% of the capital or profits interest in each
14. The related person and a person who is engaged in trades or businesses under common control (See IRC §§52(a) and (b) for more information.)

²⁰ Ibid.

Date for Determining if a Transaction Involved Related Parties

For transactions involving property, the determination of whether a taxpayer is related to another person is generally made as of **the date the property is acquired**. However, partnerships that are being terminated may be treated differently for purposes of determining if the parties to a transaction are related.

A partnership acquiring property from a terminating partnership must determine whether it is related to the terminating partnership immediately **before** the event causing the termination. For this rule, a terminating partnership is one that sells or exchanges 50% or more of its total interest in partnership capital or profits within 12 months.

Rules for Determining How Much of an Interest a Person Holds

To determine whether a person directly or indirectly owns any of the outstanding stock of a corporation or an interest in a partnership, the following rules are applied.

1. Stock or a partnership interest directly or indirectly owned by or for a corporation, partnership, estate, or trust is considered owned proportionately by its shareholders, partners, or beneficiaries. However, for a partnership interest owned by or for a C corporation, this rule applies only to shareholders who directly or indirectly own 5% or more of the value of the corporation's stock.
2. An individual is considered to own the stock or partnership interest directly or indirectly owned by or for their family.
3. An individual who owns (except by applying rule 2) any stock in a corporation is considered to own the stock directly or indirectly owned by or for their partner.
4. For purposes of rules 1, 2, or 3, stock or a partnership interest considered to be owned by a person under rule 1 is treated as actually owned by that person. However, stock or a partnership interest considered to be owned by an individual under rule 2 or 3 is not treated as owned by that individual for purposes of **reapplying** either rule 2 or 3 to attribute ownership of the same stock or partnership interest to another person.

Example 1. Jack, Mary, Hubert, and Darlene each own 25% of the corporation If It Rhymes, Inc. Jack and Mary have the same mother, Eva; however, they have different fathers. Mary is Hubert's daughter, and Darlene is Hubert's sister.

Jack directly owns 25% of the shares. He indirectly owns another 25% through his half-sister, Mary. Therefore, Jack is considered to have a 50% ownership in the company when determining whether related-party limitations apply.

Mary owns 25% of the shares directly. She indirectly owns another 25% through her half-brother, Jack, and another 25% through her father, Hubert. She therefore has a 75% interest for purposes of determining if related-party limitations apply.

Jack has to add Mary's directly owned shares to his for purposes of determining if related-party limitations apply. However, he does not have to add Hubert's shares, which are attributed to Mary indirectly under rule 2.

VEHICLE DEPRECIATION RESTRICTIONS²¹

As mentioned earlier, a vehicle must be used predominantly for qualified business use to claim the IRC §179 deduction or bonus depreciation or to calculate depreciation under MACRS. Qualified business use does **not** include the use of property as payment for the services of a 5% owner or related person.

Example 2. Snow White owns 100% of the stock in a mining company. The company provides vehicles for her and her seven managers to use for business and personal purposes. None of the seven managers are related to her in any way.

Every person who uses a company vehicle documents their mileage. The fair market value (FMV) of each employee's use of an automobile for any personal purpose is reported as income to the employee. In addition, taxes are withheld on the income.

The employees' use of company vehicles for personal purposes constitutes payment for services. It is reported as income to each employee, and required taxes are withheld. Therefore, the vehicles used by the unrelated employees are treated as being used 100% for business.

Snow's personal use of a company vehicle is not qualified business use, even though the company properly reports her personal use as income on her Form W-2, *Wage and Tax Statement*. If the business miles for the vehicle do not exceed 50% of the total miles, the vehicle must be depreciated using the straight-line method. In addition, recapture rules apply if the vehicle was previously used more than 50% for business.

Note. See the "Recapture" section of this chapter for more information.

Example 3. Use the same facts as **Example 2**, except in addition to the vehicles provided to Snow and her seven managers, the company also provides Snow's husband, David Charming, with a vehicle to use for business and personal purposes. The use of the vehicle is part of David's pay. Moreover, the company includes the value of the personal usage in David's gross income and withholds tax on it. However, as Snow's husband, David indirectly owns 100% of the company stock. Therefore, his personal use is **not** qualified business use.

IRC §179 RESTRICTIONS

Property acquired from a related person or by one component member of a controlled group from another component member of the same group does not qualify for the IRC §179 deduction. For these purposes, related parties are defined using the same items listed earlier in the "General Rules" section, except siblings are not considered related parties for purposes of restricting the IRC §179 deduction.

²¹ Ibid.

BONUS DEPRECIATION RESTRICTIONS

To qualify for bonus depreciation, the property must be new. This provision reduces the chance of related parties manipulating the situation to take undue advantage of this depreciation option. Nonetheless, **qualified leasehold improvements** are not eligible for bonus depreciation if the lease is between related parties. For these purposes, related parties include the following.

1. Members of an affiliated group
2. An individual and a member of their family, including spouses, children, parents, brothers, sisters, half-brothers, half-sisters, ancestors, and lineal descendants
3. A corporation and an individual who directly or indirectly owns **80%** or more of the value of the corporation's outstanding stock
4. Two corporations that are members of the same controlled group
5. A trust fiduciary and a corporation, if **80%** or more of the value of the outstanding stock is directly or indirectly owned by or for the trust or the grantor of the trust
6. The grantor and the fiduciary, and the fiduciary and beneficiary, of any trust
7. The fiduciaries of two different trusts, and the fiduciaries and beneficiaries of two different trusts, if the same person is the grantor of both trusts
8. A tax-exempt educational or charitable organization and any person (or, if that person is an individual, a member of their family) who directly or indirectly controls the organization
9. Two S corporations, if the same persons own more than 50% of the value of each corporation's outstanding stock
10. An S corporation and a C corporation, if the same persons own more than 50% of the value of each corporation's outstanding stock
11. A corporation and a partnership if the same persons own both of the following
 - a. **80%** or more of the value of the corporation's outstanding stock
 - b. **80%** or more of the partnership's capital or profits interest
12. The executor and the beneficiary of any estate

TERM INTERESTS THAT INVOLVE RELATED PARTIES

With certain exceptions, taxpayers **cannot** depreciate a term interest in property for any period during which the remainder interest is held, directly or indirectly, by a related person. A **term interest** means a life interest in property, an interest in property for a term of years, or an income interest in a trust. A **remainder interest** is ownership that does not take effect until the term is complete.

This rule does **not** apply if the taxpayer acquired the term interest in the property by gift, bequest, or inheritance.

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Related persons for this purpose include the following.

1. An individual and a member of their family, including only spouses, children, parents, brothers, sisters, half-brothers, half-sisters, ancestors, and lineal descendants
2. A corporation and an individual who directly or indirectly owns more than **50%** of the value of the corporation's outstanding stock
3. Two corporations that are members of the same controlled group
4. A trust fiduciary and a corporation if more than **50%** of the value of the outstanding stock is directly or indirectly owned by or for the trust or grantor of the trust
5. The grantor and the fiduciary, and the fiduciary and the beneficiary, of any trust
6. The fiduciaries of two different trusts, and the fiduciaries and the beneficiaries of two different trusts, if the same person is the grantor of both trusts
7. A tax-exempt educational or charitable organization and any person (or, if that person is an individual, a member of their family) who directly or indirectly controls the organization
8. Two S corporations, if the same persons own more than **50%** of the value of each corporation's outstanding stock
9. An S corporation and a C corporation, if the same persons own more than **50%** of the value of each corporation's outstanding stock
10. A corporation and a partnership if the same persons own both of the following
 - a. More than **50%** of the value of the corporation's outstanding stock
 - b. More than **50%** of the capital or profits interest in the partnership
11. The executor and the beneficiary of any estate

Note. For more information about property held by life tenants and remainder holders, see the 2010 *University of Illinois Federal Tax Workbook*, Chapter 5: Individual Taxpayer Problems. This chapter is available at uofi.tax/arc [www.taxschool.illinois.edu/taxbookarchive].

If the taxpayer is not allowed a depreciation deduction for a term interest in property because the holder of the remainder interest is related to them, the taxpayer must still reduce their basis in the term interest by any depreciation or amortization not allowed. However, the holder of the remainder interest increases their basis in the remainder interest by the depreciation not allowed to the term interest holder.

Example 4. Grandma Wolfbane purchased a rental house. She transferred the deed on the house to her granddaughter, Scarlet Ridgingood. However, Grandma reserved the right to the income from the rental property for the rest of her life. Grandma must report the income from the rental on her tax return, but she cannot claim any depreciation for the term interest she retained. This is because Scarlet, a related party, owns the remainder interest.

Each year that Grandma lives, the depreciation that would have been allowed except for this rule reduces her basis in the term interest. The amount that reduces Grandma's basis passes to Scarlet as an addition to her basis.

DEPRECIATION AFTER INCORPORATING²²

It is common for taxpayers to incorporate a business that was formerly a sole proprietorship. Often, the proprietorship's assets are transferred to the new corporation in exchange for stock in that corporation.

Special rules are used to determine the depreciable basis of assets contributed to a corporation in exchange for stock when the original owner of the assets retains control of the corporation after the transfer. The term **control** for these purposes means owning at least 80% of the total combined voting power of all classes of stock entitled to vote and at least 80% of the total number of shares of all other classes of the corporation's stock.²³

Note. Generally, IRC §351 allows taxpayers to contribute assets to a corporation without immediate tax consequences. However, several requirements must be met in order for the transaction to qualify for §351 tax treatment. In such transactions, the corporation obtains the same basis in the assets that the taxpayer had immediately before the transfer. For further details about §351 transactions, see the 2012 *University of Illinois Federal Tax Workbook*, Volume B, Chapter 1: S Corporations. This is available at uofi.tax/arc [www.taxschool.illinois.edu/taxbookarchive/].

TRANSFERRED ASSETS

When a sole proprietor transfers assets to a corporation and the sole proprietor remains in control of the corporation, the transferred assets are depreciated as if the transfer had not occurred. The new corporation must continue to use the same depreciation method and convention as the transferor. (Some practitioners refer to this as “stepping into the shoes” of the previous taxpayer.)

Caution. Transfers that do not meet the IRC §351 requirements could be subject to depreciation recapture and result in basis adjustments.

Example 5. Goldie operated a sole proprietorship that trained animals for use in commercials and other filmed ventures. Over the years, she purchased various pieces of equipment to help her in this endeavor.

When Goldie arrived for her appointment to have her 2014 tax return prepared, she informed her tax practitioner that she transferred the business to a new corporation, Three Bears, Inc. The incorporation date was July 1, 2014, and her attorney filed an S corporation election.

As of December 31, 2013, Goldie's depreciation schedule showed the following, in addition to various assets that were already fully depreciated.

Goldie's Schedule C Depreciation as of 12/31/2013

	Placed in Service Date	Depr. Basis	Recovery Period	Convention	\$179	Bonus	Total Prior Depr.	2013 Depr.	Accum. Depr.
Obstacle course	7/25/2007	\$35,000	15	150DB/HY			\$15,367	\$2,067	\$17,434
Transport cages	9/18/2009	15,000	7	200DB/HY	\$5,000		6,876	893	12,769
Computer and peripherals	5/11/2013	3,500	5	200DB/HY		\$1,750		350	2,100
Totals		\$53,500			\$5,000	\$1,750	\$22,243	\$3,310	\$32,303

²² Ibid.

²³ IRC §§351(a) and 368(c).

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Goldie's tax practitioner questioned her about the status of the assets. Goldie provided the following information to her.

- The articles of incorporation for the new business state that Goldie transferred \$1,000 to the corporation in exchange for 1,000 shares of common stock with no par value.
- The computer and transport cages were used only for business purposes in 2014.
- The obstacle course was a land improvement in the hands of the sole proprietor.
- Goldie did not transfer any real estate into the corporation. However, she is receiving rent income from the corporation for its use of the kennels, which were fully depreciated several years ago.

On Goldie's 2014 Schedule C, *Profit or Loss From Business*, only the depreciation expense for the six months prior to the transfer is claimed. This depreciation is shown in the following table.

Goldie's Schedule C Depreciation as of June 30, 2014

	2014 Depreciation for 12 Months	Apportioned 2014 Depreciation for 6 Months
Obstacle course	\$2,067	\$1,033
Transport cages	893	446
Computer and peripherals	560	280
Totals	\$3,520	\$1,759

For these assets, the corporation's depreciation expense must also reflect the amounts allocable to the six months the property was used by the corporation. The corporation's 2014 depreciation schedule follows. The placed-in-service dates and accumulated depreciation are carried over from the sole proprietorship.

Three Bears, Inc. Depreciation as of 12/31/2014

	Placed in Service Date	Depr. Basis	Recovery Period	Convention	Total Prior Depr.	2014 Depr. (6 Mos.)	Accum. Depr.
Obstacle course	7/25/2007	\$35,000	15	150DB/HY	\$18,467	\$1,033	\$19,500
Transport cages	9/18/2009	15,000	7	200DB/HY	13,215	446	13,661
Computer and peripherals	5/11/2013	3,500	5	200DB/HY	2,380	280	2,660
Totals		\$53,500			\$34,062	\$1,759	\$35,821

Special Issues for Transferred Vehicles

Individual taxpayers may use either the actual cost method or the standard mileage rate (SMR) to determine the amounts of their deductible vehicle expenses.²⁴ In the first year a vehicle is purchased, an individual may use the SMR, which includes a depreciation component, or they may include depreciation calculated using MACRS in the actual costs of operating the vehicle. If the taxpayer chooses to use MACRS the year the property is placed in service, then they may not switch to the SMR in a later year. However, if the taxpayer uses the SMR the year the property is placed in service, they may use actual expenses in a later year.

When a taxpayer chooses to use the business SMR the year that a vehicle is placed in service, they have elected to exclude the vehicle from MACRS. Therefore, if the taxpayer switches to deducting actual costs after having used the SMR, then they must use straight-line depreciation for the vehicle's remaining estimated useful life.²⁵

When a vehicle is transferred to a corporation from a sole proprietorship that used the SMR to calculate deductible vehicle expenses, the depreciation component of the deduction must be calculated to determine prior accumulated depreciation. Each year, the IRS publishes the amount of the depreciation component of the SMR. For example, IRS Notice 2013-80 provides information on the depreciation component of the SMR for 2010 through 2014.

For automobiles a taxpayer uses for business purposes, the portion of the business standard mileage rate treated as depreciation is 23 cents per mile for 2010, 22 cents per mile for 2011, 23 cents per mile for 2012, 23 cents per mile for 2013, and 22 cents per mile for 2014. See section 4.04 of Rev. Proc. 2010-51.²⁶

The depreciation expense deducted each year (based on the depreciation component of the SMR and any actual depreciation claimed) is added together to determine the total depreciation allowed on the vehicle. After this amount is calculated, the corporation must use the straight-line method to depreciate the vehicle.

Example 6. Use the same facts as **Example 5**, except Goldie owns a cargo van that she uses only in her business. Her tax practitioner has always used the SMR to calculate her vehicle expenses. In 2014, Goldie transferred the van's title to the corporation. Her tax practitioner calculates her accumulated depreciation upon transfer to the corporation as follows.

Year	Business Miles	Depreciation Rate in SMR	Depreciation
2013	15,000	\$0.23 per mile ²⁷	\$3,450
2014 (Jan.–Jun.)	10,000	\$0.22 per mile ²⁸	2,200
Total accumulated depreciation			\$5,650

Goldie's tax practitioner calculates the corporation's vehicle depreciation using the straight-line method over a 5-year recovery period for the six months in 2014 that the corporation owned the van.

Purchase Date	Cost Basis	Prior Depr.	Straight Line Depr. Year 2 (20%)	6 Months of SL
August 25, 2013	\$20,000	\$5,650	\$4,000	\$2,000

²⁴ Rev. Proc. 2010-51, 2010-51 IRB 883.

²⁵ Ibid.

²⁶ IRS Notice 2013-80, 2013-52 IRB 821.

²⁷ Ibid.

²⁸ Ibid.

ASSETS PURCHASED IN THE YEAR OF INCORPORATION

As discussed previously, when a sole proprietorship transfers its assets to a controlled corporation, the corporation “steps into the shoes” of the sole proprietorship for depreciation purposes for assets previously owned by the sole proprietor. However, if the first tax year of the corporation is less than 12 months, then the corporation has a short year in the year of incorporation.

Taxpayers are not allowed to use the MACRS percentage tables to determine depreciation for a short tax year.²⁹ This rule does not affect assets that were transferred from a sole proprietorship, but it does affect assets purchased after the transfer. To determine the amount of depreciation allowable, the tax practitioner must first identify which convention applies. Then the tax practitioner must calculate the depreciation using the appropriate depreciation method.

Determining the Applicable Convention in a Short Tax Year

For assets that must be depreciated using the **mid-month convention**, the length of the tax year does not affect the application of the convention. However, both the half-year and the mid-quarter conventions are applied differently in a short tax year.

Note. The mid-month convention must be used for nonresidential real property, residential rental property, and any railroad grading or tunnel bore.

The **half-year convention** is used for all assets not subject to the mid-month or mid-quarter conventions. Under the half-year convention, property is treated as being placed in service or disposed of at the midpoint of the tax year. If the short tax year either starts on the first day of a month or ends 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 only part of a month, the one partial month is treated as if it were a full month. The midpoint of the tax year is determined by dividing the number of months in the tax year by two.

Example 7. Fee, Fie, Foe, and Fum, Ltd., was incorporated on June 20, 2014. Its tax year ends on December 31. For depreciation purposes, the beginning of the 2014 tax year is June 1. Therefore, the corporation’s first tax year consists of seven months. The mid-point of the tax year is September 15 (3.5 months from the beginning of the tax year).

To determine if the taxpayer must use the **mid-quarter convention**, the basis of property placed in service in the last three months of the tax year is compared to the basis of property placed in service during the full tax year. If the basis of property placed in service in the last three months is more than 40% of the total, the taxpayer must use the mid-quarter convention. The length of the tax year does not matter. If the short tax year is three months or less, the mid-quarter convention is used for all applicable property placed in service during that tax year.

Each quarter of a short tax year is less than three months. Property depreciated using the mid-quarter convention is treated as placed in service at the midpoint of the quarter of the tax year. The midpoint of each quarter is determined by first dividing the number of months in the short tax year by four. For a short tax year of four or eight full calendar months, the quarters are based on whole months. The mid-point of each quarter is either the first day or the midpoint of a month.

²⁹ For more information on calculating depreciation for a short tax year, see Rev. Proc. 89-15, 1989-1 CB 816.

Example 8. Good King Arthur Entertainment Corporation (GKAEC) is a calendar-year taxpayer. It was incorporated and began business on May 1, 2015. It has a short tax year of eight months, ending on December 31. During 2015, GKAEC placed \$200,000 of equipment into service; \$150,000 of that equipment was placed in service in October. Because this amount comprises more than 40% of the total ($\$150,000 \div \$200,000 = 75\%$), GKAEC must use the mid-quarter convention for all assets placed in service in 2015.

Each quarter of GKAEC's 2015 tax year equals two months.

Quarter	Midpoint	Placed in Service Date
5/1–6/30	6/1	6/1
7/1–8/31	8/1	8/1
9/1–10/31	10/1	10/1
11/1–12/31	12/1	12/1

The midpoint of a quarter for a short tax year of other than four or eight full calendar months is determined using the following steps.

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

If the midpoint of a quarter, as determined in Step 3, is on a day other than the first day or midpoint of a month, then the property is treated as being placed in service on the nearest preceding first day or midpoint of that month.

Example 9. Use the same facts as **Example 8**, except GKAEC was incorporated and began business on March 15, 2015. It has a short tax year of 9.5 months, ending on December 31.

GKAEC's first step is to determine the midpoint of each quarter.

1. The short tax year (beginning March 15 and ending December 31, 2015) consists of 292 days.
2. The length of each quarter is 73 days ($292 \div 4$).
3. The midpoint of each quarter is the 37th day of the quarter ($73 \div 2$).

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

Quarter	Midpoint	Placed in Service Date
3/15–5/26	4/20	4/15
5/27–8/7	7/2	7/1
8/8–10/19	9/13	9/1
10/20–12/31	11/25	11/15

Calculating MACRS Depreciation for a Short Tax Year

MACRS depreciation for a short year is the prorated amount of a full year's depreciation based on the number of months the property is treated as having been in service under the applicable convention.

Example 10. Handsome Lancelot Escorts incorporated on March 15, 2015. Its tax year ends on December 31. On March 16, it purchased a computer for \$1,000. This is the only property the corporation placed in service during the short tax year.

The corporation does not claim a §179 deduction. The half-year convention and the 200% declining balance method apply. The MACRS depreciation rate is 20% for the year the asset is placed in service.

The computer is treated as being placed in service on August 1 (the midpoint of the short tax year). The corporation is allowed to deduct \$167 ($\$1,000 \text{ basis} \times (5 \text{ months in service} \div 6 \text{ months of the half-year convention}) \times 20\% \text{ depreciation rate}$).

Example 11. Use the same facts as **Example 10**, except the computer was purchased on October 16, 2015. The corporation must apply the mid-quarter convention because more than 40% of the property placed in service that year was purchased in the last three months of the tax year.

The property is treated as if it were placed in service on September 1, 2015. (See **Example 9** for computation.) Under MACRS, the corporation is allowed four months of depreciation. The corporation multiplies the basis by 40% to calculate the depreciation for a full tax year ($\$1,000 \times 40\% = \400). The corporation then multiplies \$400 by $\frac{4}{12}$ to calculate the short tax-year depreciation of \$133.

Calculating Depreciation After a Short Tax Year

Either of the following methods can be used to calculate the depreciation for the years after a short tax year.³⁰

- The simplified method
- The allocation method

Once the taxpayer selects a method, they must use it consistently.

Simplified Method. Under the simplified method, depreciation is calculated by multiplying the adjusted basis of the property at the beginning of the year by the applicable depreciation rate.

Example 12. Use the same facts as **Example 10**. The corporation claimed depreciation of \$167 for the 2015 short tax year. The computer's adjusted basis on January 1, 2016, is \$833 ($\$1,000 - \167). The 2016 depreciation is \$333 ($40\% \times \833).

Allocation Method. Under the allocation method, depreciation for each later tax year is calculated by allocating to that year the depreciation attributable to the parts of the recovery years that fall within that year. For each recovery year included, the depreciation is calculated by multiplying the depreciation attributable to that recovery year by a fraction. The fraction's numerator is the number of months included in both the tax year and the recovery year. The denominator is 12. The allowable depreciation for the tax year is the sum of the depreciation for each recovery year occurring in that tax year.

³⁰ IRS Pub. 946, *How To Depreciate Property*.

Example 13. Use the same facts as **Example 10**, except the first recovery year for the 5-year property placed in service during the short tax year runs from August 1, 2015, to July 31, 2016. The taxpayer deducted five months of the first recovery year on its tax return for the 2015 short year. Seven months of the first recovery year and five months of the second recovery year fall within the 2016 tax year. The depreciation for 2016 is \$333, which is calculated as follows.

Prorated depreciation for the first recovery year:		
Basis	\$1,000	
Depreciation rate	× 40%	
Total 1st recovery year depreciation	\$ 400	
Prorated for number of months in first recovery year	× 7/12	
Allocated depreciation for first recovery year	\$ 233	\$233
Prorated depreciation for second recovery year:		
Basis	\$1,000	
Less: total depreciation for 1st recovery year (\$167 + \$233)	(400)	
Adjusted basis at the start of 2nd recovery year	\$ 600	
Depreciation rate	× 40%	
Total second recovery year depreciation	\$ 240	
Prorated for number of months in second recovery year	× 5/12	
Allocated depreciation for second recovery year	\$ 100	100
Total depreciation for 2016		\$333

DEPRECIATION OF ASSETS ACQUIRED AS A GIFT

Special rules apply to property acquired as a gift. For example, a gift does not qualify for the IRC §179 deduction because the property was not purchased by the taxpayer. The determination of the basis for depreciation purposes and the amount of deductible loss on the eventual sale of the asset are also treated differently for property received as a gift.

The first step in determining the depreciation deduction allowable for property received as a gift is to determine the donor's adjusted basis, the FMV of the property at the time of the gift, and any gift tax paid by the donor on the gift.

The donor's adjusted basis plus a portion of the gift tax paid by the donor is used by the **taxpayer** to establish their depreciable basis in the gift. However, unlike a related party transaction (described earlier), the taxpayer does not "step into the shoes" of the donor. Instead, the taxpayer starts the depreciation recovery period as of the date of the gift, using the applicable convention and method.

Example 14. Grandpa decided it was time to abandon his summer home and move permanently to Florida, where his new girlfriend lives. On April 30, 2015, he gave his house to his niece, Peggy Higglety, to do with as she pleased. The FMV of the property at that time was \$250,000. Grandpa's basis in the home was \$200,000. He filed Form 709, *United States Gift (and Generation-Skipping Transfer) Tax Return*, but did not owe any gift tax.

Peggy decides to use the house as rental property. On her 2015 return, she reports the acquisition date as April 30, 2015, and a beginning basis of \$200,000. Residential real estate is depreciated over 27.5 years using the mid-month convention and the straight-line method.

For gifts received after 1976, a portion of the gift tax that was paid on the gift is added to the basis. This is calculated by multiplying the gift tax by a fraction. The numerator of the fraction is the net increase in value of the gift, and the denominator is the amount of the gift. The **net increase in value of the gift** is the FMV of the gift less the donor's adjusted basis. The **amount of the gift** is its value for gift tax purposes after reduction for any annual exclusion and marital or charitable deduction that applies.³¹

³¹ IRS Pub. 551, *Basis of Assets*.

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Example 15. Use the same facts as **Example 14**, except Grandpa paid \$2,000 for the gift tax due with Form 709. The net increase in the value of the gift was \$50,000 (the FMV of \$250,000 less Grandpa's basis of \$200,000). The amount of the taxable gift for gift tax purposes was \$236,000 (\$250,000 FMV – \$14,000 annual exclusion for 2015). The amount of the gift tax that is added to Peggy's basis is \$424 (\$2,000 gift tax \times (\$50,000 net increase in value \div \$236,000 taxable gift amount)).

If the FMV of the property at the date of the gift is less than the donor's adjusted basis, the depreciable value is still equal to the donor's adjusted basis plus the applicable portion of gift tax paid. However, if the taxpayer who received the gift sells the property at a loss, the basis for calculating the loss is the FMV of the property at the time the taxpayer received the gift plus or minus any required adjustments to basis while the taxpayer held the property.³²

If the result is a loss when the adjusted basis is used to calculate a gain and the result is a gain when the FMV is used to calculate a loss, the taxpayer has neither a gain nor a loss on the sale of the property.

Example 16. Use the same facts as **Example 14**, except the FMV of the property at the time of the gift is \$100,000. Peggy sells the property in 2020 for \$125,000. At that time, her adjusted basis after taking depreciation and selling costs into account is \$170,000. She cannot deduct a loss on the sale because the selling price is more than the FMV at the time she received it. However, she also does not have to report a gain on the sale because the selling price is less than her adjusted basis.

Peggy reports the sale in part I of Form 4797, *Sales of Business Property*.

Note. If the selling price exceeded Peggy's basis, she would have to claim only the gain in excess of her basis. The FMV at the time of the gift would not be relevant to the calculation of gain.

DEPRECIATION OF ASSETS ACQUIRED IN LIKE-KIND EXCHANGES

Before Treas. Reg. §1.168(i)-6 was enacted, when property was acquired in a like-kind exchange (or involuntary conversion), the remaining basis in relinquished property was added to any new basis in the acquired property and the total was depreciated over the life of the acquired property. This method of depreciation is sometimes called "the old method."

However, under Treas. Reg. §1.168(i)-6, MACRS property acquired in a like-kind exchange is treated as having two cost components for depreciation purposes: the old basis and the new basis. The **old basis** is the remaining basis from the relinquished property (also called **carryover basis**). The **new basis** is the boot (i.e., cash or non-like-kind property given to "even out" an exchange), if any, paid in the exchange.

Note. Although there are two cost components for depreciation purposes, the asset continues to have a single adjusted cost basis for purposes of calculating any gain or loss on disposition. Using the methods described in the regulations, the new basis is required to be separately depreciated as newly purchased MACRS property. The taxpayer generally continues to depreciate the carryover basis of the property over the remaining recovery period and uses the same depreciation method and convention as the relinquished property. However, this only applies when the acquired property has the same or a shorter recovery period and the same or a more accelerated depreciation method than the property relinquished.

³² Ibid.

Example 17. On December 31, 1999, Rumpel Stiltskin purchased a condominium in Florida for \$300,000 for rental purposes. On January 1, 2015, he traded the property for an apartment building in Las Vegas. He also paid \$20,000 to the prior owner of the Las Vegas rental property as part of the exchange.

Rumpel's basis in the Florida condominium on the date of the trade was \$135,456 (\$300,000 cost – \$164,544 accumulated depreciation). He renamed the building on his depreciation schedule to "Formerly FLA now Vegas." On his 2015 tax return, he claims the entire annual depreciation amount on the property as if no trade had occurred. He will depreciate the carryover basis over the remaining 12.5 years of the condominium's 27.5-year recovery period.

Rumpel also establishes a new depreciation item for the \$20,000 boot he paid as part of the trade. This boot is depreciated over 27.5 years starting in January 2015.

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

Example 18. On July 7, 2005, Kris Kringle purchased residential property for \$100,000. He used this property to house his elves during the height of their busy season, when they are not allowed to leave the factory grounds. The recovery period of the property was 27.5 years.

As of December 2014, Kris had claimed a total of \$34,391 in depreciation and his adjusted basis was \$65,609 (\$100,000 – \$34,391). On January 1, 2015, he traded the residential property to Winter Warlock for a warehouse. Kris will use the warehouse to manufacture electronic devices. This was an even trade with no boot. The warehouse has a recovery period of 39 years.

The warehouse has a longer recovery period than the residential property. Thus, Kris is **not** allowed to continue the depreciation over the remaining 18-year recovery period of the residential property (27.5 year-recovery period – 9.5 years of use). If he had originally purchased commercial property, it would have **29.5 years remaining before it was completely depreciated (39-year recovery period – 9.5 years of use)**.

Kris must depreciate the carryover basis of \$65,609 by the number of years remaining in the newly acquired property's recovery period. His 2015 depreciation is \$2,224 (\$65,609 carryover basis ÷ 29.5 remaining years.)

As noted in the following table, instead of using the procedures in Treas. Reg. §1.168(i)-6(i), the taxpayer can **elect out of the regulations**.

Replacement Property Has:	Applicable Rule
Same MACRS recovery period and same or faster depreciation method	(a) Apply the same depreciation method and convention to the carryover basis as used for the relinquished property (b) Elect out of rules under Treas. Reg. §1.168(i)-6(i)
MACRS recovery period of replacement asset shorter than traded asset and same or faster depreciation method	(a) Apply the same depreciation method and convention to the carryover basis as used for the relinquished property (b) Elect out of rules under Treas. Reg. §1.168(i)-6(i)
MACRS recovery period of replacement asset longer than traded asset and same or slower depreciation method	(a) Apply the longer recovery period and slower depreciation method to the carryover basis (b) Elect out of rules under Treas. Reg. §1.168(i)-6(i)

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If the taxpayer elects out, then the adjusted basis of the relinquished asset is treated as if it were disposed of at the time of the exchange. The entire basis of the acquired asset (reflecting both the carryover basis of the relinquished property and any boot paid) is depreciated using the recovery period for the acquired asset. The property is treated as if it were placed in service on the later of:

- The date the acquired property was placed in service, or
- The date of the disposition of the relinquished property.³³

Electing out is done on an asset-by-asset basis by the due date (including extensions) of the return for the year of replacement. A statement should be attached to the return indicating “Election Made Under Section 1.168(i)-6(i).” Once made, the election cannot be revoked without IRS consent. In the case of a partnership, S corporation, or consolidated group, the election is made by the partnership, the S corporation, or the common parent of the consolidated group, respectively.

Electing out does not affect the amount of gain or loss recognized on the exchange. It merely starts a fresh recovery period for the acquired property. The primary benefit of electing out is that identifying the following is easier.

- Which assets the taxpayer is holding
- The basis of property when an asset is sold (If this method is not used, it can be difficult to determine which assets on the depreciation schedule should be included in the basis of the relinquished property.)

The primary disadvantage of electing out is that it produces the least amount of depreciation in the first year. It also extends the length of time it takes to fully depreciate the acquired asset.

Example 19. Use the same facts as **Example 18**, except Kris elects out of Treas. Reg. §1.168(i)-(6)(i). Instead of depreciating the newly acquired commercial property over 29.5 years, he must treat it as placed in service on January 1, 2015, and depreciate it over 39 years. His annual depreciation is \$1,682 (\$65,609 carryover basis ÷ 39-year recovery period).

Note. For more information about electing out of the rules under Treas. Reg. 1.168(i)-6(i), see the instructions for Form 4562, *Depreciation and Amortization*.

The following additional rules apply to depreciation of assets acquired in like-kind exchanges.

1. The carryover basis in the newly acquired asset is **not eligible** for IRC §179.
2. The carryover basis is **qualified** for bonus depreciation if the newly acquired asset meets the other eligibility criteria.
3. The boot paid is eligible for both IRC §179 and bonus depreciation if all other requirements are met.

³³ IRS Pub. 946, *How To Depreciate Property*.

HOME OFFICE**HOME OFFICE DEPRECIATION**

Typically, if the taxpayer's home is a single-family residence and part of it is used as an office, the home office portion may be depreciated as nonresidential real property over 39 years.

Note. If the home is an apartment in a building that is residential rental property owned by the taxpayer, the office portion is depreciated as residential rental property over 27.5 years.

The taxpayer can elect to use the **safe harbor method** for deducting home office expenses instead of the **actual expense method**. A taxpayer who uses the safe harbor method **cannot** deduct any depreciation for the qualified home office for the tax year covered by the election. The depreciation deduction **allowable** for the home office for that tax year is deemed to be zero.

The safe harbor method requires an **annual election** that must be made on a timely filed original tax return using Schedule C. The election is made simply by using this method. However, once made, **the election is irrevocable for that tax year**.

The depreciation deduction for the home office may save both income and self-employment (SE) taxes, depending on the taxpayer's situation. Whether the taxpayer is better off using the safe harbor method or the actual expense method for a taxpayer's home office deduction depends on several factors, including the following.

- The amount of deductible mortgage interest the taxpayer pays
- The amount of real estate taxes on the home
- The taxpayer's overall tax rate
- Whether the taxpayer has already incurred the maximum amount of social security tax on SE income
- The taxpayer's liability for the additional Medicare tax

The tax practitioner should consider all these factors annually — as well as the potential for tax on the future sale of the home — when advising a client on the best option for any particular year.

Note. More information about deducting home office expenses can be found in the 2014 *University of Illinois Federal Tax Workbook*, Volume C, Chapter 4: Special Taxpayers.

GAIN ON THE SALE OF A HOME

Married filing jointly (MFJ) taxpayers may exclude from their income up to \$500,000 of gain on the sale of their principal residence. A single or married filing separately (MFS) taxpayer may exclude up to \$250,000.³⁴ To qualify, the taxpayer must have owned and used the dwelling as their principal residence for at least two years during the 5-year period ending on the date of the sale. A reduced exclusion amount is available if certain qualifications are met.

³⁴ IRC §121.

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However, if part of the taxpayer's home was used as a qualified home office, the portion of any gain from the sale that is attributable to depreciation allowed or allowable after May 6, 1997, on the home office is taxable income for the taxpayer in the year of the sale. That income is reported as unrecaptured IRC §1250 gain on Schedule D, *Capital Gains and Losses*. This gain is **taxed at a maximum rate of 25%**.

Note. If a taxpayer meets certain conditions, the sale of the home is reported on Form 8949, *Sales and Other Dispositions of Capital Assets*. More information about the sale of a principal residence can be found in the 2014 *University of Illinois Federal Tax Workbook*, Volume C, Chapter 3: Capital Gains and Losses.

As mentioned earlier, if the taxpayer elects to use the safe harbor method for deducting home office expenses, the allowable depreciation of the home office for the tax year is zero. This may mean future tax savings for some taxpayers.

Example 20. Kwan Lee is a tax professional. In January 2013, she began using one room in her residence exclusively and regularly to meet with clients, provide accounting services, and prepare tax returns. She qualifies to claim a home office deduction. In 2013, Kwan's home office depreciation deduction was \$492. From 2014 through 2024, her depreciation deduction is \$513 each year. As of January 2025, her accumulated depreciation is \$6,135 (\$492 + (\$513 × 11 years)).

In January 2025, Kwan sells the home for a gain. The sale qualifies for the IRC §121 exclusion for the sale of a principal residence, but the gain attributable to the depreciation claimed in prior years is taxable. The maximum tax rate on the gain is 25%. Therefore, depending on Kwan's other income, she could pay as much as \$1,534 in federal taxes due to the sale (\$6,135 × 25%). The amount of tax savings from claiming the depreciation expense varied each year from 2013–2024.

If Kwan used the safe harbor method for determining her home office deduction during these years, none of the gain would be attributable to depreciation. Therefore, none of the gain would be taxable.

RECAPTURE

IRC §179

The **disposition** of property used predominantly in a trade or business that was expensed, in whole or in part, using IRC §179 does not result in recapture of the §179 deduction.³⁵ The §179 expense is subject to the same rules as any other depreciation taken on that property in determining the tax rate paid on the sale or disposition.

However, IRC §179 expensing of an asset is subject to **recapture** if the asset's **business use falls to 50% or less** during the recovery period. The amount recaptured is the §179 deduction taken minus the MACRS depreciation that would have been allowed on the asset from the time the property was placed in service up to and including the year of recapture.³⁶

Part IV of Form 4797 is used to report the recapture of an IRC §179 deduction. The §179 deduction is reported on line 33(a), and the recomputed depreciation is reported on line 34(a). The difference is entered on line 35(a), and it is also reported as other income on the schedule on which the original deduction was taken.³⁷

³⁵ Treas. Reg. §1.179-1(e)(2).

³⁶ See Treas. Reg. §1.179-1(e)(1).

³⁷ Instructions for Form 4797.

Example 21. Polly owns a small restaurant called Polly's Kettle, which she operates as a sole proprietorship. In 2012, she purchased a new stove. She elected to write off the entire \$20,000 cost of the stove using IRC §179. She did not purchase any other assets and did not elect out of bonus depreciation.

On January 1, 2014, Polly took the stove out of her restaurant and moved it to her new home. At the restaurant, the stove was used entirely for business purposes. At her home, it is only used 25% for business when she is concocting new recipes.

The portion of the IRC §179 deduction that must be recaptured is calculated as follows.

IRC §179 deduction in 2012		\$20,000
Recomputed depreciation for 2012 and 2013 using MACRS:		
50% bonus depreciation	\$10,000	
2012 half-year convention, 200% DB	1,429	
2013 half-year convention, 200% DB	2,449	
Total recomputed depreciation	\$13,878	(13,878)
Depreciation taken in excess of amount allowed without the IRC §179 deduction		\$ 6,122

The recapture is reported on the following 2014 Form 4797. The \$6,122 is reported as other income on Polly's Schedule C, and it is subject to both ordinary income tax and SE tax. However, the basis in the property also increases by the amount recaptured.

32 Sub other than casualty or theft on Form 4797, line 32

Part IV Recapture Amounts Under Sections 179 and 280F(b)(2) When Business Use Drops to 50% or Less
(see instructions)

		(a) Section 179	(b) Section 280F(b)(2)
33 Section 179 expense deduction or depreciation allowable in prior years	33	20,000	
34 Recomputed depreciation (see instructions)	34	13,878	
35 Recapture amount. Subtract line 34 from line 33. See the instructions for where to report	35	6,122	

Form 4797 (2014)

Observations for Example 21.

1. No provision requires the recapture of **bonus depreciation** for most assets, including Polly's stove. However, there is a provision that requires recapture if the asset is **listed property** under IRC §280F (discussed next).
2. If the asset Polly acquired in 2012 had been used property instead of new, bonus depreciation would not have been applicable in 2012. In that case, the amount of the recapture would have been higher.

BONUS DEPRECIATION OF LISTED PROPERTY

Bonus depreciation is generally not subject to recapture **unless** the asset is **listed property** under IRC §280F. If business use of listed property falls to 50% or less after the first year, depreciation taken in excess of the amount allowed under the ADS must be recaptured.³⁸ To calculate the excess depreciation, all depreciation is taken into account, including bonus depreciation, IRC §179 expenses, and MACRS depreciation. Depreciation under ADS is calculated using the straight-line method, and it may be subject to a different recovery period than MACRS depreciation.

³⁸ IRC §280F(b)(2).

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Example 22. In June 2010, Brandon Wax, owner of Candlestick Makers, purchased and placed in service a new sports utility vehicle (SUV) that cost \$28,000. During the 2010–2013 tax years, he used it **exclusively** for qualified business purposes.

In 2010, Brandon claimed a \$10,000 IRC §179 deduction on the SUV and \$9,000 of bonus depreciation. He began depreciating the balance of the purchase price using the 200% declining-balance method over a 5-year GDS recovery period. The SUV's gross vehicle weight is over 6,000 pounds, so it is not subject to the annual limits for depreciation of passenger vehicles.

During 2014, Brandon's business use of the vehicle dropped to 50%. He must calculate the excess depreciation and include it in his 2014 gross income. The excess depreciation is calculated as follows.

Total depreciation claimed for 2010 through 2013:		
IRC §179 expense	\$10,000	
Bonus depreciation	9,000	
2010 MACRS depreciation	1,800	
2011 MACRS depreciation	2,880	
2012 MACRS depreciation	1,728	
2013 MACRS depreciation	1,037	
Total depreciation claimed 2010–2013	\$26,445	\$26,445
Depreciation allowable using the straight-line method and ADS recovery life of five years:		
2010 (10% of \$28,000)	\$ 2,800	
2011 (20% of \$28,000)	5,600	
2012 (20% of \$28,000)	5,600	
2013 (20% of \$28,000)	5,600	
Total depreciation allowable 2010–2013	\$19,600	(19,600)
Excess depreciation		\$ 6,845

This **\$6,845** is shown in part IV of Form 4797 and carried to Brandon's 2014 Schedule C. It is subject to both ordinary income tax and SE tax.

32		other than casualty or theft on Form 4797, line 32		32
Part IV Recapture Amounts Under Sections 179 and 280F(b)(2) When Business Use Drops to 50% or Less (see instructions)				
		(a) Section 179	(b) Section 280F(b)(2)	
33	Section 179 expense deduction or depreciation allowable in prior years	33		26,445
34	Recomputed depreciation (see instructions)	34		19,600
35	Recapture amount. Subtract line 34 from line 33. See the instructions for where to report	35		6,845

Form **4797** (2014)

Note. Excess depreciation that is recaptured under these rules is added back to the basis of the property. However, for property depreciated using the straight-line method and ADS property life, the amount of depreciation allowable in the year that business use drops to 50% or less is not changed by this adjustment. In **Example 22**, the 2014 depreciation is still 20% of \$28,000 (\$5,600) before it is allocated to business and nonbusiness use.

DEPRECIATION RECAPTURE IN GENERAL

Except as previously explained for IRC §179 and bonus depreciation, recapture of depreciation taken in prior years does not occur unless the property is sold or otherwise disposed of. When disposition occurs, any realized and recognized gain is taxable. The recapture provisions determine the portion of the gain taxed as:

- Ordinary income,
- Unrecaptured IRC §1250 gain, or
- Capital gain.

These recapture provisions do **not** require that the gain be included in SE income — even if the original deduction was for property used in an activity considered to be self employment.

IRC §1245 Property

When IRC §1245 property is sold, the taxpayer is required to report as ordinary income the lesser of the gain realized or the depreciation allowed or allowable on the asset. In general, this rule applies to depreciable **personal property** and **certain types of real property**, such as single-purpose agricultural and horticultural structures and property used as an integral part of production. Personal property includes both tangible and intangible property.³⁹

Example 23. In 2010, Willie Winkie purchased the client list and other intangible assets that Billie Binkie had developed during the 50 years he was in the tax and accounting business. At that time, Willie did not purchase any of the tangible personal assets or real property that Billie had used in his business. Instead, he leased them from Billie.

The purchase price of the intangible property was \$15,000. All of it qualified for amortization under IRC §197 starting on July 1, 2009.

In 2014, Willie sold the practice to Millie. Millie paid Willie \$20,000 for the intangible property on December 31, 2014. (Millie leases the tangible personal assets and real property from Billie's widow, Willow.)

From July 1, 2009, to December 31, 2014, Willie claimed amortization on the intangibles of \$4,500. His adjusted basis in the property is \$10,500 (\$15,000 – \$4,500).

Willie's gain on the sale is \$9,500, which is calculated as follows.

Sales price	\$20,000
Less: basis	<u>(10,500)</u>
Gain	\$ 9,500

Of the gain, \$4,500 is attributable to amortization and \$5,000 is the amount of the gain that results from the selling price (\$20,000) being greater than the original purchase price (\$15,000). The \$4,500 is taxed at Willie's ordinary tax rate. The \$5,000 is taxed at Willie's capital gains rate.

Willie reports the sale in part III of Form 4797.

³⁹ Treas. Reg. §1.1245-3(b).

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For Example 23

Form 4797 (2014)

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Part III Gain From Disposition of Property Under Sections 1245, 1250, 1252, 1254, and 1255 (see instructions)					
19	(a) Description of section 1245, 1250, 1252, 1254, or 1255 property:	(b) Date acquired (mo., day, yr.)	(c) Date sold (mo., day, yr.)		
A	Intangible assets	01/01/2010	12/31/2014		
B					
C					
D					
These columns relate to the properties on lines 19A through 19D. ►		Property A	Property B	Property C	Property D
20	Gross sales price (Note: See line 1 before completing.)	20	20,000		
21	Cost or other basis plus expense of sale	21	15,000		
22	Depreciation (or depletion) allowed or allowable	22	4,500		
23	Adjusted basis. Subtract line 22 from line 21.	23	10,500		
24	Total gain. Subtract line 23 from line 20	24	9,500		
25	If section 1245 property:				
a	Depreciation allowed or allowable from line 22	25a	4,500		
b	Enter the smaller of line 24 or 25a	25b	4,500		
If section 1250 property: If straight line depreciation was used.					

IRC §1250 Property

Accelerated Depreciation on IRC §1250 Property. Generally, IRC §1250 property includes all depreciable real property that is not §1245 property. If any depreciation was claimed on an accelerated basis (such as bonus depreciation or special property that qualified for certain tax incentives) and the property is sold, a portion of the gain attributable to the accelerated depreciation is taxed as ordinary income. The amount taxed as ordinary income is the lesser of the gain realized or the depreciation claimed that is in excess of the amount that would have been allowed using the straight-line method.

Example 24. Kitty purchased and placed in service a machine shed for her cotton harvesting equipment on September 11, 2011, for \$50,000. The machine shed is 20-year property and was eligible for 100% bonus depreciation in 2011, which Kitty used. In 2015, she sold the shed and the parcel of ground it was on to Mitten's, Inc., for \$35,000.

The contract for sale allocated \$30,000 of the sales price to the shed and \$5,000 of the price to the land. Kitty's basis in the land is \$1,000.

The tax consequences of the **sale of the shed** are calculated as follows.

Basis in machine shed:	
Purchase price	\$50,000
Less: depreciation claimed	(50,000)
Remaining basis	\$ 0
Gain realized:	
Sales price	\$30,000
Less: remaining basis	(0)
Realized gain	\$30,000
Excess depreciation:	
Bonus depreciation claimed	\$50,000
Less: straight-line depreciation allowable (half-year convention)	(10,000)
Bonus depreciation in excess of straight-line	\$40,000
Amount of gain taxed as ordinary income:	
Realized gain	\$30,000
Excess depreciation	40,000
Lesser of realized gain or excess depreciation	\$30,000

The \$30,000 gain is taxed as ordinary income to Kitty.

The tax consequences of the **sale of the land** are calculated as follows.

Sales price	\$5,000
Less: basis	(1,000)
Realized gain	\$4,000

The realized gain on the sale of the land is taxed at capital gains rates.

Note. Accelerated depreciation does not qualify for the 25% maximum rate that applies to the gain attributable to depreciation for most types of real estate.⁴⁰ More information on the 25% rate is provided in the next section.

Unrecaptured IRC §1250 Gain. Straight-line depreciation of IRC §1250 property is not subject to recapture when the property is sold or otherwise disposed of. However, the portion of the gain attributable to straight-line depreciation is **treated as ordinary income** except that the maximum tax rate for individual taxpayers on that portion of the gain is capped at 25%.⁴¹

Example 25. Mouse purchased a rental house in August 2005. The purchase price was \$120,000, \$20,000 of which was allocated to land. From 2005 to 2015, he claimed a total of \$36,361 in depreciation. All of this depreciation was calculated using the straight-line method, because bonus or other accelerated depreciation methods were not available for residential real estate in 2005.

Mouse sold the property in August 2015 for a total of \$180,000. The tax consequences of the sale are calculated as follows.

Sales price	\$180,000
Less: adjusted basis in property (\$120,000 – \$36,361)	(83,639)
Total gain	\$ 96,361
Less: portion of the gain attributable to straight-line depreciation	(36,361)
Remaining portion of the gain attributable to appreciation	\$ 60,000

The portion of the gain attributable to straight-line depreciation — which is called the **unrecaptured IRC §1250 gain** — is taxed as ordinary income up to a maximum rate of 25%.

The remaining portion of the gain is taxed as a capital gain.

Note. The §1250 recapture rules vary according to the date the property was placed in service and the method of depreciation claimed. The percentage used to calculate the amount taxable as ordinary income because of additional depreciation varies depending on whether the property is nonresidential real property, residential real property, or low-income housing. For more information, see the instructions for Form 4797.

Real Estate Placed in Service Between 1980 and 1987. The depreciation deduction for real property placed in service between 1980 and 1987 may have been calculated using the accelerated cost recovery system (ACRS). Generally, if a gain is realized on the sale of an asset that was depreciated under ACRS, the depreciation component of the gain is taxed as ordinary income under IRC §1245. As a result, the 25% limit on the income tax rate attributable to depreciation of real property does not apply.

⁴⁰ Treas. Reg. §1.168(k)-1(f)(3).

⁴¹ IRC §1(h)(1)(E).

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This rule does not apply to residential rental property. It also does not apply to real property depreciated under the alternate ACRS method.

Note. For more information, see the “Dispositions of Depreciable Property” section in IRS Pub. 544, *Sales and Other Dispositions of Assets (For use in preparing 1994 Returns)*. This publication can be found at [uofi.tax/15b1x1 \[www.irs.gov/pub/irs-prior/p544--1994.pdf\]](http://www.irs.gov/pub/irs-prior/p544--1994.pdf).

Recapture Under IRC §291 for C Corporations. Under IRC §291, a C corporation that realizes a gain on §1250 property may be required to recapture part of the depreciation claimed on the property even if recapture is not otherwise required. The amount treated as ordinary income is 20% of the excess, if any, of:

- The amount that would be treated as ordinary income if the property were §1245 property, **minus**
- The amount treated as ordinary income under §1250.

Because there is no preferential capital gains rate for corporations, the §291 adjustment is usually not a major consideration. However, the recharacterization of income has an impact in years in which the C corporation has capital losses in excess of capital gains because the excess capital losses of the corporation cannot be used to offset ordinary income.⁴²

IRC §291 also applies to an S corporation that was a C corporation in any of the three immediately preceding tax years.⁴³

DEPRECIATION RECAPTURE ON RESIDENCE USED AS RENTAL PROPERTY

For sales and exchanges of personal residences after December 31, 2008, the Housing Assistance Tax Act of 2008 reduced the exclusion of eligible gain under IRC §121 to the extent that gain is allocated to nonqualified usage. Starting in 2009, a portion of the gain on a principal residence may be taxable if the house was used other than as a principal residence. This prevents taxpayers from selling a second home, vacation home, or rental home and excluding all of the gain even if they meet the §121 two-out-of-five-years ownership and use tests.

Note. For more information about the sale of a principal residence, including a discussion of the ownership and use tests, see the 2014 *University of Illinois Federal Tax Workbook*, Volume C, Chapter 3: Capital Gains and Losses.

Nonqualified usage is any period after December 31, 2008, that the property is not used as the principal residence of the taxpayer, spouse, or former spouse. The period of nonqualified use does **not** include any portion of the 5-year period ending on the date of sale that is after the last date the property is used as the taxpayer’s (or spouse’s) principal residence.⁴⁴

The gain allocated to nonqualified use is calculated using the following formula.

$$\text{Gain allocated to nonqualified use} = \text{Total Gain} \times \frac{\text{Aggregate periods of nonqualified use}}{\text{Total period of time taxpayer owned property}}$$

Recapture of depreciation is applied before the gain allocated to periods of nonqualified use. The gain allocated to nonqualified use is based on the total gain less any gain recognized due to depreciation after May 6, 1997.

⁴² IRC §1211(a).

⁴³ IRC §1363(b)(4).

⁴⁴ IRC §121(b)(5)(C)(ii).

Example 26. Travis, who is single, purchased a house on May 22, 2008, for \$200,000. Travis moved in on that date and lived in the house until May 31, 2010, when he moved out of the house and put it up for rent. The house was rented from June 1, 2010, to March 31, 2012. Travis claimed depreciation deductions for 2010 through 2012 totaling \$10,000. Travis moved back into the house on April 1, 2012, and lived there until he sold the house on January 31, 2014, for \$390,000.

Travis owned and lived in the house for more than two years during the 5-year period ending on the date of sale, as shown in the following table.

5-Year Period	Used as Home	Used as Rental
Jan. 31, 2009–May 31, 2010	16 months	
Jun. 1, 2010–Mar. 31, 2012		22 months
Apr. 1, 2012–Jan. 31, 2014	22 months	
Total	38 months	22 months (670 days)

During the period Travis owned the house (2,080 days), his period of nonqualified use was 670 days. He can exclude \$128,798 of the gain, as shown in the following table.

Sales price	\$390,000
Basis (\$200,000 purchase price – \$10,000 depreciation)	(190,000)
Total gain	\$200,000
Unrecaptured §1250 gain (depreciation)	(10,000)
Remaining gain to be allocated	\$190,000
Taxable gain due to nonqualified use ($(670 \div 2,080) \times \$190,000$) treated as long-term capital gain	(61,202)
Remaining gain excluded under §121	\$128,798

The sale of Travis's residence is reported on Form 8949, *Sales and Other Dispositions of Capital Assets*. The amounts from Form 8949 flow to Schedule D, *Capital Gains and Losses*. These forms follow.

Note. For detailed information about reporting transactions on Form 8949 and Schedule D, see the 2014 *University of Illinois Federal Tax Workbook*, Volume C, Chapter 3: Capital Gains and Losses.

Form 8949 (2014)

Attachment Sequence No. **12A** Page **2**

Name(s) shown on return. Name and SSN or taxpayer identification no. not required if shown on other side
Travis Social security number or taxpayer identification number
111-22-3333

Before you check Box D, E, or F below, see whether you received any Form(s) 1099-B or substitute statement(s) from your broker. A substitute statement will have the same information as Form 1099-B. Either may show your basis (usually your cost) even if your broker did not report it to the IRS. Brokers must report basis to the IRS for most stock you bought in 2011 or later (and for certain debt instruments you bought in 2014 or later).

Part II Long-Term. Transactions involving capital assets you held more than 1 year are long term. For short-term transactions, see page 1.

Note. You may aggregate all long-term transactions reported on Form(s) 1099-B showing basis was reported to the IRS and for which no adjustments or codes are required. Enter the total directly on Schedule D, line 8a; you are not required to report these transactions on Form 8949 (see instructions).

You must check Box D, E, or F below. Check only one box. If more than one box applies for your long-term transactions, complete a separate Form 8949, page 2, for each applicable box. If you have more long-term transactions than will fit on this page for one or more of the boxes, complete as many forms with the same box checked as you need.

- ☐ **(D)** Long-term transactions reported on Form(s) 1099-B showing basis was reported to the IRS (see **Note** above)
☐ **(E)** Long-term transactions reported on Form(s) 1099-B showing basis was **not** reported to the IRS
☒ **(F)** Long-term transactions not reported to you on Form 1099-B

1	(a) Description of property (Example: 100 sh. XYZ Co.)	(b) Date acquired (Mo., day, yr.)	(c) Date sold or disposed (Mo., day, yr.)	(d) Proceeds (sales price) (see instructions)	(e) Cost or other basis. See the Note below and see Column (e) in the separate instructions	Adjustment, if any, to gain or loss. If you enter an amount in column (g), enter a code in column (f). See the separate instructions.		(h) Gain or (loss). Subtract column (e) from column (d) and combine the result with column (g)
						(f) Code(s) from instructions	(g) Amount of adjustment	
	House	5/22/08	1/31/14	390,000	190,000	H	(128,798)	71,202

2015 Workbook

For Example 26

SCHEDULE D (Form 1040)

Department of the Treasury
Internal Revenue Service (99)

Capital Gains and Losses

► Attach to Form 1040 or Form 1040NR.
► Information about Schedule D and its separate instructions is at www.irs.gov/scheduled.
► Use Form 8949 to list your transactions for lines 1b, 2, 3, 8b, 9, and 10.

OMB No. 1545-0074

2014
Attachment
Sequence No. **12**

Name(s) shown on return

Travis

Your social security number

111-22-3333

Part I Short-Term Capital Gains and Losses—Assets Held One Year or Less

See instructions for how to figure the amounts to enter on the lines below.

This form may be easier to complete if you round off cents to whole dollars.

	(d) Proceeds (sales price)	(e) Cost (or other basis)	(g) Adjustments to gain or loss from Form(s) 8949, Part I, line 2, column (g)	(h) Gain or (loss) Subtract column (e) from column (d) and combine the result with column (g)
1a Totals for all short-term transactions reported on Form 1099-B for which basis was reported to the IRS and for which you have no adjustments (see instructions). However, if you choose to report all these transactions on Form 8949, leave this line blank and go to line 1b .				
1b Totals for all transactions reported on Form(s) 8949 with Box A checked				
2 Totals for all transactions reported on Form(s) 8949 with Box B checked				
3 Totals for all transactions reported on Form(s) 8949 with Box C checked				
4 Short-term gain from Form 6252 and short-term gain or (loss) from Forms 4684, 6781, and 8824 .				4
5 Net short-term gain or (loss) from partnerships, S corporations, estates, and trusts from Schedule(s) K-1				5
6 Short-term capital loss carryover. Enter the amount, if any, from line 8 of your Capital Loss Carryover Worksheet in the instructions				6 ()
7 Net short-term capital gain or (loss). Combine lines 1a through 6 in column (h). If you have any long-term capital gains or losses, go to Part II below. Otherwise, go to Part III on the back				7

Part II Long-Term Capital Gains and Losses—Assets Held More Than One Year

See instructions for how to figure the amounts to enter on the lines below.

This form may be easier to complete if you round off cents to whole dollars.

	(d) Proceeds (sales price)	(e) Cost (or other basis)	(g) Adjustments to gain or loss from Form(s) 8949, Part II, line 2, column (g)	(h) Gain or (loss) Subtract column (e) from column (d) and combine the result with column (g)
8a Totals for all long-term transactions reported on Form 1099-B for which basis was reported to the IRS and for which you have no adjustments (see instructions). However, if you choose to report all these transactions on Form 8949, leave this line blank and go to line 8b .				
8b Totals for all transactions reported on Form(s) 8949 with Box D checked				
9 Totals for all transactions reported on Form(s) 8949 with Box E checked				
10 Totals for all transactions reported on Form(s) 8949 with Box F checked	390,000	190,000	(128,798)	71,202
11 Gain from Form 4797, Part I; long-term gain from Forms 2439 and 6252; and long-term gain or (loss) from Forms 4684, 6781, and 8824				11
12 Net long-term gain or (loss) from partnerships, S corporations, estates, and trusts from Schedule(s) K-1				12
13 Capital gain distributions. See the instructions				13
14 Long-term capital loss carryover. Enter the amount, if any, from line 13 of your Capital Loss Carryover Worksheet in the instructions				14 ()
15 Net long-term capital gain or (loss). Combine lines 8a through 14 in column (h). Then go to Part III on the back				15 71,202

For Paperwork Reduction Act Notice, see your tax return instructions.

Cat. No. 11338H

Schedule D (Form 1040) 2014

For Example 26

Schedule D (Form 1040) 2014

Page **2**

Part III Summary

<p>16 Combine lines 7 and 15 and enter the result</p> <ul style="list-style-type: none"> • If line 16 is a gain, enter the amount from line 16 on Form 1040, line 13, or Form 1040NR, line 14. Then go to line 17 below. • If line 16 is a loss, skip lines 17 through 20 below. Then go to line 21. Also be sure to complete line 22. • If line 16 is zero, skip lines 17 through 21 below and enter -0- on Form 1040, line 13, or Form 1040NR, line 14. Then go to line 22. <p>17 Are lines 15 and 16 both gains? <input type="checkbox"/> Yes. Go to line 18. <input type="checkbox"/> No. Skip lines 18 through 21, and go to line 22.</p> <p>18 Enter the amount, if any, from line 7 of the 28% Rate Gain Worksheet in the instructions . . . ▶</p> <p>19 Enter the amount, if any, from line 18 of the Unrecaptured Section 1250 Gain Worksheet in the instructions ▶</p> <p>20 Are lines 18 and 19 both zero or blank? <input type="checkbox"/> Yes. Complete the Qualified Dividends and Capital Gain Tax Worksheet in the instructions for Form 1040, line 44 (or in the instructions for Form 1040NR, line 42). Do not complete lines 21 and 22 below. <input checked="" type="checkbox"/> No. Complete the Schedule D Tax Worksheet in the instructions. Do not complete lines 21 and 22 below.</p> <p>21 If line 16 is a loss, enter here and on Form 1040, line 13, or Form 1040NR, line 14, the smaller of: • The loss on line 16 or • (\$3,000), or if married filing separately, (\$1,500) }</p> <p>Note. When figuring which amount is smaller, treat both amounts as positive numbers.</p> <p>22 Do you have qualified dividends on Form 1040, line 9b, or Form 1040NR, line 10b? <input type="checkbox"/> Yes. Complete the Qualified Dividends and Capital Gain Tax Worksheet in the instructions for Form 1040, line 44 (or in the instructions for Form 1040NR, line 42). <input type="checkbox"/> No. Complete the rest of Form 1040 or Form 1040NR.</p>	<p>16</p> <p>18</p> <p>19 10,000</p> <p>21 ()</p>
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Schedule D (Form 1040) 2014

Observations for Example 26.

1. The total gain of \$71,202 consists of \$61,202 of gain due to nonqualified use and \$10,000 of unrecaptured §1250 gain.
2. The unrecaptured §1250 gain is entered on line 19 of Schedule D.

CORRECTING DEPRECIATION

In working with new clients, practitioners may find that these individuals did not deduct the correct amount of depreciation for their assets. This is generally discovered when the taxpayer sells the property and asks a practitioner for assistance.

FILING AN AMENDED RETURN

A taxpayer that did not deduct the correct amount of depreciation in any year may be able to make a correction by filing an amended return for that year. A taxpayer can file an amended return to correct the depreciation amount claimed for any property in any of the following situations.

- The taxpayer claimed the incorrect amount because of a mathematical error made in any year.
- The taxpayer claimed the incorrect amount because of a posting error made in any year.
- The taxpayer has not **adopted a method of accounting** for property placed in service in tax years ending after December 29, 2003.

Note. A taxpayer adopts a method of accounting for depreciation by using a permissible method of determining depreciation when they file their first tax return, or by using the same impermissible method of determining depreciation on two or more consecutively filed tax returns. For an exception to the 2-year rule, see Rev. Proc. 2015-14. For more information about changes in accounting methods, see IRM 4.11.6.2.

- The taxpayer claimed the incorrect amount on property placed in service in tax years ending before December 30, 2003.

If an amended return is allowed, the taxpayer must file it by the later of the following.

- Three years from the date the taxpayer filed their original return for the year in which they did not deduct the correct amount (A return filed before an unextended due date is considered filed on that due date.)
- Two years from the time the taxpayer paid their tax for that year

FILING FORM 3115

If the taxpayer does not qualify to correct their depreciation by filing an amended return, the IRS has provided taxpayers with an alternative method for correcting depreciation. Despite the general rule that mistakes cannot be corrected after the statute of limitations expires, missed depreciation can be corrected even long after the asset should have been fully depreciated.

Form 3115, *Application for Change in Accounting Method*, is used to notify the IRS of the correction. Unfortunately, Form 3115 is one of the most complicated forms issued by the IRS. It is designed to cover hundreds of different situations that result in a change in accounting method. Tax practitioners using the form should pay careful attention to the detailed instructions provided by the IRS and should review the revenue procedures applicable to the requested change.

Correcting depreciation is generally covered under the automatic change procedures, which do not require the taxpayer to obtain IRS consent before making the change. Form 3115 can be filed with the tax return and does not require an application fee under the automatic change procedures. **Filing Form 3115 to claim previously unclaimed depreciation allows the taxpayer to deduct, in the current year, the entire amount of depreciation not previously deducted.**

A taxpayer who did not claim any of the allowable depreciation for certain assets on prior years' returns and is claiming the missed depreciation on the current year's return is changing from an impermissible method to a permissible method. The total amount of missed depreciation includes the depreciation that should have been taken in both open and closed years. This total is reported as an "other expense" on the appropriate schedule of the taxpayer's return for the year of the change.

Note. Examples of completed Forms 3115 for other types of changes are included in the 2015 *University of Illinois Federal Tax Workbook*, Volume B, Chapter 5: Capitalization vs. Repair Update.

Example 27. Toni was excited when she heard that Jack and Jill Hill made an appointment for help in preparing their 2015 income tax returns. However, when she first met with them, she was surprised to learn that they had never taken a depreciation deduction for any of their five rental properties. The Hills had purchased these rental properties between 2002 and 2015. The Hills' average annual gross receipts were \$100,500 (as determined under Treas. Reg. §1.263(a)-3(h)(3)) for the three preceding tax years. They were not currently involved in any IRS examinations.

After attending a tax seminar, Toni was pleased to learn that she could prepare Form 3115 to claim all of the depreciation deductions the Hills had missed when they were preparing their own returns. She was even more pleased to learn that the total of all the missed depreciation could be deducted on the taxpayer's 2015 Form 1040, Schedule E, *Supplemental Income and Loss*.

Toni calculated that the total prior years' depreciation was \$63,091. She completed Form 3115 to document the adjustment and notify the IRS about the change. The missed depreciation for each property was deducted on line 19 (other expenses) of Schedule E, and the description "Form 3115 §481(a) adjustment" was entered on the description line. This is shown on the following Schedule E, copy 1 and copy 2. Column C of copy 1 does not show an amount for the Form 3115 deduction because the rental property reported in this column was placed in service in 2015. Therefore, there is no Form 3115 deduction for this property.

1 Single		2 Multi-Family Residence		4 Commercial		6 Royalties		8 Other (describe)	
Income:		Properties:		A		B		C	
3	Rents received	3		7,800		5,100		2,100	
4	Royalties received	4							
Expenses:									
5	Advertising	5							
6	Auto and travel (see instructions)	6							
7	Cleaning and maintenance	7		395		385		380	
8	Commissions	8							
9	Insurance	9						1,130	
10	Legal and other professional fees	10							
11	Management fees	11							
12	Mortgage interest paid to banks, etc. (see instructions)	12							
13	Other interest	13							
14	Repairs	14		2,942		1,140		2,914	
15	Supplies	15							
16	Taxes	16		2,393					
17	Utilities	17							
18	Depreciation expense or depletion	18		1,405		1,396		393	
19	Other (list) ▶ Form 3115	19		17,153		291			
20	Total expenses. Add lines 5 through 19	20		24,288		3,212		4,817	
21	Subtract line 20 from line 3 (rents) and/or 4 (royalties). If result is a (loss), see instructions to find out if you must file Form 6198	21		(16,488)		1,888		(2,717)	
22	Deductible rental real estate loss after limitation, if any, on Form 8582 (see instructions)	22		(5,855)				(965)	
23a	Total of all amounts reported on line 3 for all rental properties	23a				25,200			
b	Total of all amounts reported on line 4 for all royalty properties	23b							
c	Total of all amounts reported on line 12 for all properties	23c				5,796			
d	Total of all amounts reported on line 18 for all properties	23d				8,268			
e	Total of all amounts reported on line 20 for all properties	23e				99,022			
24	Income. Add positive amounts shown on line 21. Do not include any losses	24						1,888	
25	Losses. Add royalty losses from line 21 and rental real estate losses from line 22. Enter total losses here	25						(26,888)	
26	Total rental real estate and royalty income or (loss). Combine lines 24 and 25. Enter the result here. If Parts II, III, IV, and line 40 on page 2 do not apply to you, also enter this amount on Form 1040, line 17, or Form 1040NR, line 18. Otherwise, include this amount in the total on line 41 on page 2	26						25,000	

For Paperwork Reduction Act Notice, see the separate instructions.

Cat. No. 11344L

Schedule E (Form 1040) 2015

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For Example 27

Income:		Properties:	A	B	C
3	Rents received	3	1,800	8,400	
4	Royalties received	4			
Expenses:					
5	Advertising	5			
6	Auto and travel (see instructions)	6			
7	Cleaning and maintenance	7			
8	Commissions	8			
9	Insurance	9	410	400	
10	Legal and other professional fees	10			
11	Management fees	11			
12	Mortgage interest paid to banks, etc. (see instructions)	12	2,874	2,922	
13	Other interest	13			
14	Repairs	14	600	3,100	
15	Supplies	15			
16	Taxes	16	2,808	2,870	
17	Utilities	17			
18	Depreciation expense or depletion	18	2,258	2,816	
19	Other (list) ▶ Form 3115 \$481(a) adjustment	19	26,052	19,595	
20	Total expenses. Add lines 5 through 19	20	35,002	31,703	
21	Subtract line 20 from line 3 (rents) and/or 4 (royalties). If result is a (loss), see instructions to find out if you must file Form 6198	21	(33,202)	(23,303)	
22	Deductible rental real estate loss after limitation, if any, on Form 8582 (see instructions)	22	(11,792)	(8,276)	()
Total of all amounts reported on line 3 for all rental properties			23a		

Note. In this example, the deductible rental losses were limited to \$25,000 in 2015 in accordance with the rules for passive activity losses. The excess losses carry forward to future years. For more information about rental activity losses, see the 2014 *University of Illinois Federal Tax Workbook*, Volume B, Chapter 4: Passive Activities.

Explanation of Certain Entries on the Hills' Form 3115

In the identification section of Form 3115, the entries for “tax year of change” relate to the tax year in which the change is being reported. The Hills qualify to file a simplified version of Form 3115 because their average annual receipts do not exceed \$10 million.⁴⁵ Under the rules for small business taxpayers making this type of change in accounting method,⁴⁶ they are only required to complete the following information on Form 3115.

1. The identification section of page 1 (above part I)
2. The signature section at the bottom of page 1
3. Part I
4. Part II, all lines **except** 13, 15, 17, and 19
5. Part IV, all lines **except** line 25
6. Schedule E

Note. For more information about Form 3115 and the simplified procedures for small business taxpayers, see the 2015 *University of Illinois Federal Tax Workbook*, Volume B, Chapter 5: Capitalization vs. Repair Update.

⁴⁵ As calculated under Treas. Reg. §1.263(a)-3(h)(3).

⁴⁶ Rev. Proc. 2015-14, 2015-5 IRB 450.

Part I: Information for Automatic Change Request

Line 1(a). The designated change number for this particular adjustment is “7.” This number is found in the instructions for Form 3115 under “List of Automatic Accounting Method Changes.”

Part III: Information for Advance Consent Request

The Hills’ change is approved under the automatic change procedures. Therefore, they do not have to complete this section.

Part IV: Section 481(a) Adjustment

Line 26. On this line, Jack and Jill Hill inform the IRS that they are deducting \$63,091 on their 2015 return due to the change in depreciation method. The calculation of their adjustment is shown in the attachments to Form 3115.

Line 27. The Hills’ change decreases their taxable income. Therefore, they make the entire adjustment on the tax return for the year of the change.

Schedule E: Change in Depreciation or Amortization

Line 1. None of the Hills’ rental property was purchased before 1980. Therefore, the depreciation on these assets is not determined under Treas. Reg. §1.167(a)-11.

Lines 5 through 7. The information requested for these lines is provided in the attachment to Form 3115.

2015 Workbook

For Example 27

Form 3115 (Rev. December 2015) Department of the Treasury Internal Revenue Service	Application for Change in Accounting Method ► Information about Form 3115 and its separate instructions is at www.irs.gov/form3115 .	OMB No. 1545-0152				
Name of filer (name of parent corporation if a consolidated group) (see instructions) Jack and Jill Hill		Identification number (see instructions) 321-11-3115				
Number, street, and room or suite no. If a P.O. box, see the instructions. 6900 Fantasy Way		Principal business activity code number (see instructions) 531120				
City or town, state, and ZIP code Urbana, IL 61801		Tax year of change begins (MM/DD/YYYY) 01/01/2015 Tax year of change ends (MM/DD/YYYY) 12/31/2015				
Name of applicant(s) (if different than filer) and identification number(s) (see instructions)		Name of contact person (see instructions) Toni Smith				
Contact person's telephone number 217-555-3115						
If the applicant is a member of a consolidated group, check this box. <input type="checkbox"/>						
If Form 2848 , Power of Attorney and Declaration of Representative, is attached (see instructions for when Form 2848 is required), check this box. <input checked="" type="checkbox"/>						
Check the box to indicate the type of applicant.						
<input checked="" type="checkbox"/> Individual <input type="checkbox"/> Corporation <input type="checkbox"/> Controlled foreign corporation (Sec. 957) <input type="checkbox"/> 10/50 corporation (Sec. 904(d)(2)(E)) <input type="checkbox"/> Qualified personal service corporation (Sec. 448(d)(2)) <input type="checkbox"/> Exempt organization. Enter Code section ►						
<input type="checkbox"/> Cooperative (Sec. 1381) <input type="checkbox"/> Partnership <input type="checkbox"/> S corporation <input type="checkbox"/> Insurance co. (Sec. 816(a)) <input type="checkbox"/> Insurance co. (Sec. 831) <input type="checkbox"/> Other (specify) ►						
Check the appropriate box to indicate the type of accounting method change being requested. See instructions. <input checked="" type="checkbox"/> Depreciation or Amortization <input type="checkbox"/> Financial Products and/or Financial Activities of Financial Institutions <input type="checkbox"/> Other (specify) ►						
Caution: To be eligible for approval of the requested change in method of accounting, the taxpayer must provide all information that is relevant to the taxpayer or to the taxpayer's requested change in method of accounting. This includes (1) all relevant information requested on this Form 3115 (including its instructions), and (2) any other relevant information, even if not specifically requested on Form 3115. The taxpayer must attach all applicable statements requested throughout this form.						
Part I Information for Automatic Change Request						
1 Enter the applicable designated automatic accounting method change number ("DCN") for the requested automatic change. Enter only one DCN, except as provided for in guidance published by the IRS. If the requested change has no DCN, check "Other," and provide both a description of the change and a citation of the IRS guidance providing the automatic change. See instructions.		<table border="1" style="width: 100%; border-collapse: collapse;"> <tr> <th style="width: 50%;">Yes</th> <th style="width: 50%;">No</th> </tr> <tr> <td></td> <td></td> </tr> </table>	Yes	No		
Yes	No					
a (1) DCN: <u>7</u> (2) DCN: (3) DCN: (4) DCN: (5) DCN: (6) DCN: (7) DCN: (8) DCN: (9) DCN: (10) DCN: (11) DCN: (12) DCN:						
b Other <input type="checkbox"/> Description ►						
2 Do any of the eligibility rules restrict the applicant from filing the requested change using the automatic change procedures (see instructions)? If "Yes," attach an explanation.		<table border="1" style="width: 100%; border-collapse: collapse;"> <tr> <th style="width: 50%;">Yes</th> <th style="width: 50%;">No</th> </tr> <tr> <td></td> <td style="text-align: center;">x</td> </tr> </table>	Yes	No		x
Yes	No					
	x					
3 Has the filer provided all the information and statements required (a) on this form and (b) by the List of Automatic Changes under which the applicant is requesting a change? See instructions. Note: Complete Part II and Part IV of this form, and, Schedules A through E, if applicable.		<table border="1" style="width: 100%; border-collapse: collapse;"> <tr> <th style="width: 50%;">Yes</th> <th style="width: 50%;">No</th> </tr> <tr> <td style="text-align: center;">x</td> <td></td> </tr> </table>	Yes	No	x	
Yes	No					
x						
Part II Information for All Requests						
4 During the tax year of change, did or will the applicant (a) cease to engage in the trade or business to which the requested change relates, or (b) terminate its existence? See instructions.		<table border="1" style="width: 100%; border-collapse: collapse;"> <tr> <th style="width: 50%;">Yes</th> <th style="width: 50%;">No</th> </tr> <tr> <td></td> <td style="text-align: center;">x</td> </tr> </table>	Yes	No		x
Yes	No					
	x					
5 Is the applicant requesting to change to the principal method in the tax year of change under section 1.381(c)(4)-1(d)(1) or 1.381(c)(5)-1(d)(1)? If "No," go to line 6a. If "Yes," the applicant cannot file a Form 3115 for this change. See instructions.		<table border="1" style="width: 100%; border-collapse: collapse;"> <tr> <th style="width: 50%;">Yes</th> <th style="width: 50%;">No</th> </tr> <tr> <td></td> <td style="text-align: center;">x</td> </tr> </table>	Yes	No		x
Yes	No					
	x					
Sign Here	Under penalties of perjury, I declare that I have examined this application, including accompanying schedules and statements, and to the best of my knowledge and belief, the application contains all the relevant facts relating to the application, and it is true, correct, and complete. Declaration of preparer (other than applicant) is based on all information of which preparer has any knowledge. Signature of filer (and spouse, if joint return) _____ Date _____ Name and title (print or type) Jack and Jill Hill, Taxpayers					
Preparer (other than filer/applicant)	Print/Type preparer's name Toni Smith Preparer's signature _____ Date _____ Firm's name ► Lavon Tax Service					

For Privacy Act and Paperwork Reduction Act Notice, see the instructions.

Cat. No. 19280E

Form **3115** (Rev. 12-2015)

For Example 27

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Page **2**

Part II Information for All Requests (continued)		Yes	No
6a	Does the applicant (or any present or former consolidated group in which the applicant was a member during the applicable tax year(s)) have any federal income tax return(s) under examination (see instructions)? If "No," go to line 7a.		x
b	Is the method of accounting the applicant is requesting to change an issue under consideration (with respect to either the applicant or any present or former consolidated group in which the applicant was a member during the applicable tax year(s))? See instructions.		
c	Enter the name and telephone number of the examining agent and the tax year(s) under examination. Name ▶ _____ Telephone number ▶ _____ Tax year(s) ▶ _____		
d	Has a copy of this Form 3115 been provided to the examining agent identified on line 6c?		
7a	Does audit protection apply to the applicant's requested change in method of accounting? See instructions. If "No," attach an explanation.		x
b	If "Yes," check the applicable box and attach the required statement. <input type="checkbox"/> Not under exam <input type="checkbox"/> 3-month window <input type="checkbox"/> 120 day: Date examination ended ▶ _____ <input type="checkbox"/> Method not before director <input type="checkbox"/> Negative adjustment <input type="checkbox"/> CAP: Date member joined group ▶ _____ <input type="checkbox"/> Audit protection at end of exam <input type="checkbox"/> Other		
8a	Does the applicant (or any present or former consolidated group in which the applicant was a member during the applicable tax year(s)) have any federal income tax return(s) before Appeals and/or a federal court? If "No," go to line 9.		x
b	Is the method of accounting the applicant is requesting to change an issue under consideration by Appeals and/or a federal court (for either the applicant or any present or former consolidated group in which the applicant was a member for the tax year(s) the applicant was a member)? See instructions. If "Yes," attach an explanation.		
c	If "Yes," enter the name of the (check the box) <input type="checkbox"/> Appeals officer and/or <input type="checkbox"/> counsel for the government, telephone number, and the tax year(s) before Appeals and/or a federal court. Name ▶ _____ Telephone number ▶ _____ Tax year(s) ▶ _____		
d	Has a copy of this Form 3115 been provided to the Appeals officer and/or counsel for the government identified on line 8c?		
9	If the applicant answered "Yes" to line 6a and/or 8a with respect to any present or former consolidated group, attach a statement that provides each parent corporation's (a) name, (b) identification number, (c) address, and (d) tax year(s) during which the applicant was a member that is under examination, before an Appeals office, and/or before a federal court.		
10	If for federal income tax purposes, the applicant is either an entity (including a limited liability company) treated as a partnership or an S corporation, is it requesting a change from a method of accounting that is an issue under consideration in an examination, before Appeals, or before a federal court, with respect to a federal income tax return of a partner, member, or shareholder of that entity?		x
11a	Has the applicant, its predecessor, or a related party requested or made (under either an automatic or non-automatic change procedure) a change in method of accounting within any of the five tax years ending with the tax year of change? If "No," go to line 12.		x
b	If "Yes," for each trade or business, attach a description of each requested change in method of accounting (including the tax year of change) and state whether the applicant received consent.		
c	If any application was withdrawn, not perfected, or denied, or if a Consent Agreement granting a change was not signed and returned to the IRS, or the change was not made or not made in the requested year of change, attach an explanation.		
12	Does the applicant, its predecessor, or a related party currently have pending any request (including any concurrently filed request) for a private letter ruling, change in method of accounting, or technical advice? If "Yes," for each request attach a statement providing (a) the name(s) of the taxpayer, (b) identification number(s), (c) the type of request (private letter ruling, change in method of accounting, or technical advice), and (d) the specific issue(s) in the request(s).		x
13	Is the applicant requesting to change its overall method of accounting? If "Yes," complete Schedule A on page 4 of the form.		

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For Example 27

Form 3115 (Rev. 12-2015)

Page **3**

Part II Information for All Requests (continued)		Yes	No						
14	If the applicant is either (i) not changing its overall method of accounting, or (ii) changing its overall method of accounting and changing to a special method of accounting for one or more items, attach a detailed and complete description for each of the following (see instructions): a The item(s) being changed. b The applicant's present method for the item(s) being changed. c The applicant's proposed method for the item(s) being changed. d The applicant's present overall method of accounting (cash, accrual, or hybrid).								
15a	Attach a detailed and complete description of the applicant's trade(s) or business(es). b If the applicant has more than one trade or business, as defined in Regulations section 1.446-1(d), describe (i) whether each trade or business is accounted for separately; (ii) the goods and services provided by each trade or business and any other types of activities engaged in that generate gross income; (iii) the overall method of accounting for each trade or business; and (iv) which trade or business is requesting to change its accounting method as part of this application or a separate application.								
16a	Attach a full explanation of the legal basis supporting the proposed method for the item being changed. Include a detailed and complete description of the facts that explains how the law specifically applies to the applicant's situation and that demonstrates that the applicant is authorized to use the proposed method. b Include all authority (statutes, regulations, published rulings, court cases, etc.) supporting the proposed method. c Include either a discussion of the contrary authorities or a statement that no contrary authority exists.								
17	Will the proposed method of accounting be used for the applicant's books and records and financial statements? For insurance companies, see the instructions. If "No," attach an explanation.								
18	Does the applicant request a conference with the IRS National Office if the IRS National Office proposes an adverse response?		x						
19a	If the applicant is changing to either the overall cash method, an overall accrual method, or is changing its method of accounting for any property subject to section 263A, any long-term contract subject to section 460 (see 19b), or inventories subject to section 474, enter the applicant's gross receipts for the 3 tax years preceding the tax year of change. <table border="1"> <tr> <td>1st preceding year ended: mo. yr.</td> <td>2nd preceding year ended: mo. yr.</td> <td>3rd preceding year ended: mo. yr.</td> </tr> <tr> <td>\$</td> <td>\$</td> <td>\$</td> </tr> </table> b If the applicant is changing its method of accounting for any long-term contract subject to section 460, in addition to completing 19a, enter the applicant's gross receipts for the 4th tax year preceding the tax year of change: 4th preceding year ended: mo. yr. \$	1st preceding year ended: mo. yr.	2nd preceding year ended: mo. yr.	3rd preceding year ended: mo. yr.	\$	\$	\$		
1st preceding year ended: mo. yr.	2nd preceding year ended: mo. yr.	3rd preceding year ended: mo. yr.							
\$	\$	\$							
Part III Information for Non-Automatic Change Request		Yes	No						
20	Is the applicant's requested change described in any revenue procedure, revenue ruling, notice, regulation, or other published guidance as an automatic change request? If "Yes," attach an explanation describing why the applicant is submitting its request under the non-automatic change procedures.								
21	Attach a copy of all documents related to the proposed change (see instructions).								
22	Attach a statement of the applicant's reasons for the proposed change.								
23	If the applicant is a member of a consolidated group for the year of change, do all other members of the consolidated group use the proposed method of accounting for the item being changed? If "No," attach an explanation.								
24a	Enter the amount of user fee attached to this application (see instructions). ▶ \$								
b	If the applicant qualifies for a reduced user fee, attach the required information or certification (see instructions).								

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For Example 27

Form 3115 (Rev. 12-2015)

Page 4

Part IV Section 481(a) Adjustment		Yes	No
25	Does published guidance require the applicant (or permit the applicant and the applicant is electing) to implement the requested change in method of accounting on a cut-off basis? If "Yes," attach an explanation and do not complete lines 26, 27, and 28 below.		
26	Enter the section 481(a) adjustment. Indicate whether the adjustment is an increase (+) or a decrease (-) in income. ► \$ (63,091) Attach a summary of the computation and an explanation of the methodology used to determine the section 481(a) adjustment. If it is based on more than one component, show the computation for each component. If more than one applicant is applying for the method change on the application, attach a list of the (a) name, (b) identification number, and (c) the amount of the section 481(a) adjustment attributable to each applicant.		
27	Is the applicant making an election to take the entire amount of the adjustment into account in the tax year of change? If "Yes," check the box for the applicable elective provision used to make the election (see instructions). <input type="checkbox"/> \$50,000 de minimis election <input type="checkbox"/> Eligible acquisition transaction election		
28	Is any part of the section 481(a) adjustment attributable to transactions between members of an affiliated group, a consolidated group, a controlled group, or other related parties? If "Yes," attach an explanation.		x

11	Other costs		
----	-----------------------	--	--

Schedule E—Change in Depreciation or Amortization. See instructions.

Applicants requesting approval to change their method of accounting for depreciation or amortization complete this section. Applicants **must** provide this information for each item or class of property for which a change is requested.

Note: See the **Summary of the List of Automatic Accounting Method Changes** in the instructions for information regarding automatic changes under sections 56, 167, 168, 197, 1400I, 1400L, or former section 168. **Do not** file Form 3115 with respect to certain late elections and election revocations. See instructions.

1	Is depreciation for the property determined under Regulations section 1.167(a)-11 (CLADR)?	<input type="checkbox"/> Yes	<input checked="" type="checkbox"/> No
If "Yes," the only changes permitted are under Regulations section 1.167(a)-11(c)(1)(iii).			
2	Is any of the depreciation or amortization required to be capitalized under any Code section such as, section 263A?	<input type="checkbox"/> Yes	<input checked="" type="checkbox"/> No
If "Yes," enter the applicable section ►			
3	Has a depreciation, amortization, expense, or disposition election been made for the property such as, the election under sections 168(f)(1), 168(i)(4), 179, 179C, or Regulations section 1.168(i)-8(d)?	<input type="checkbox"/> Yes	<input checked="" type="checkbox"/> No
If "Yes," state the election made ►			
4a	To the extent not already provided, attach a statement describing the property subject to the change. Include in the description the type of property, the year the property was placed in service, and the property's use in the applicant's trade or business or income-producing activity.		
b	If the property is residential rental property, did the applicant live in the property before renting it?	<input type="checkbox"/> Yes	<input checked="" type="checkbox"/> No
c	Is the property public utility property?	<input type="checkbox"/> Yes	<input checked="" type="checkbox"/> No
5	To the extent not already provided in the applicant's description of its present method, attach a statement explaining how the property is treated under the applicant's present method (for example, depreciable property, inventory, property, supplies, etc.).		

2015 Workbook

For Example 27

Jack and Jill Hill

SS# 321-11-3115 & 321-12-3115

FORM 3115 ATTACHMENT

This Form 3115 is filed for the following properties:

E1	A	4200 Rainbow Circle Urbana, IL 61801
E1	B	4000 Rainbow Court Urbana, IL 61801
E2	A	8000 Pegasus St. Urbana, IL 61801
E2	B	8200 Butterfly Landing Urbana, IL 61801

Note: No change is being made for property C (6900 Unicorn Point) on Schedule E, Copy 1 because this property was placed in service in 2015.

Part II

- Q14 **a. Items being changed:** Depreciation of residential real estate used in rental activity
- b. Present method:** No depreciation was taken
- c. Proposed method:** Calculate depreciation using 27.5-year life starting when properties purchased.
- d. Present overall accounting method:** Cash

Part IV

Q26 The correct amount of depreciation for each property is calculated using straight-line, mid-month convention over 27.5 years.

Property E1A: 4200 Rainbow Circle Urbana, IL 61801

The cost of the real estate including improvements was \$46,000. The amount of the cost allocated to land is \$7,360 based on the county assessor records.

		Improper Depr.	Per Year	Proper Depr.	IRC §481 Adj.
1	2002	\$0	\$ 293	\$ 293	(\$ 293)
2	2003 through 2014	0	1,405	16,860	(16,860)
					(\$17,153)

Property E1B: 4000 Rainbow Court Urbana, IL 61801

The cost of the real estate including improvements was \$44,500. The amount of the cost allocated to land is \$6,120 based on the county assessor records.

		Improper Depr.	Per Year	Proper Depr.	IRC §481 Adj.
1	2014	\$0	\$291	\$291	(\$291)
					(\$291)

For Example 27

Property E2A: 8000 Pegasus St Urbana, IL 61801

The cost of the real estate including improvements was \$65,000. The amount of the cost allocated to land is \$2,922 based on the county assessor records.

		Improper Depr.	Per Year	Proper Depr.	IRC §481 Adj.
1	2003	\$0	\$1,223	\$ 1,223	(\$ 1,223)
2	2004 through 2014	0	2,257	24,829	(24,829)
					(\$26,052)

Property E2B: 8200 Butterfly Landing Urbana, IL 61801

The cost of the real estate including improvements was \$80,000. The amount of the cost allocated to land is \$2,556 based on the county assessor records.

		Improper Depr.	Per Year	Proper Depr.	IRC §481 Adj.
1	2007	\$0	\$2,699	\$ 2,699	(\$ 2,699)
2	2008 through 2013	0	2,816	16,896	(16,896)
					(\$19,595)

Schedule E - Change in Depreciation or Amortization

5	See Q14b above	
7a	Code section under which the property is depreciated:	IRC §167
7b	Asset class:	Residential real estate
7c	Facts in support of method:	See above
7d	Depr method:	§168(b)(3)(B)— Straight line
7e	Recovery period:	27.5
7f	Convention:	Mid-month convention
7g	First-year special depreciation allowance not claimed for any of the properties because the properties were not eligible.	

APPENDIX

DEPRECIATION PROBLEMS

The following problems and solutions are intended to give the reader the opportunity to put the material presented in this chapter to practical use. To arrive at the solution for a particular problem, a practitioner may need to:

1. Use the list of nine classes and/or both tables in appendix B of IRS Pub. 946 (provided at the end of this chapter);
2. Understand the requirements for an asset to qualify for bonus depreciation or IRC §179 (including the extended effective dates as modified by TIPA); and/or
3. Apply the special limitations applicable to listed property.

For the following problems, the reader should indicate if the property is eligible IRC §179 property, if it qualifies for bonus depreciation, and which recovery period applies to it. The property may also be subject to additional limitations, which the reader should note. All the businesses in these problems use a calendar tax year.

Solutions to these problems can be found in the next section.

Problem 1

Frog Princes, LLC, is a tax preparation service. It purchased a new hydraulic hand dolly for \$1,200 on January 1, 2015. It uses the dolly to distribute boxes of printing paper to each preparer's office.

IRC §179 Property?	Qualifies for Bonus Depreciation?	Recovery Period?
<input type="checkbox"/> Yes <input type="checkbox"/> No	<input type="checkbox"/> Yes <input type="checkbox"/> No	_____

Problem 2

Golden Ball, Inc., is a demolition company. On July 1, 2014, it purchased a new desk for its managing partner for \$20,000.

IRC §179 Property?	Qualifies for Bonus Depreciation?	Recovery Period?
<input type="checkbox"/> Yes <input type="checkbox"/> No	<input type="checkbox"/> Yes <input type="checkbox"/> No	_____

Problem 3

The Woodcutter's Wife is a retail establishment selling handcrafted religious statues. On January 2, 2014, it purchased a used display case for its showroom that cost \$45,000.

IRC §179 Property?	Qualifies for Bonus Depreciation?	Recovery Period?
<input type="checkbox"/> Yes <input type="checkbox"/> No	<input type="checkbox"/> Yes <input type="checkbox"/> No	_____

Problem 4

Faithful Johannes, Inc., owns a construction enterprise. On March 15, 2014, it purchased a used crane for use in its construction projects. The crane cost \$600,000. The company invested a total of \$2.3 million in equipment during the year.

IRC §179 Property?	Qualifies for Bonus Depreciation?	Recovery Period?
<input type="checkbox"/> Yes <input type="checkbox"/> No	<input type="checkbox"/> Yes <input type="checkbox"/> No	_____

Problem 5

Steve Stranger is a self-employed fiddler who performs at various venues during the year. On September 23, 2014, he purchased a new Lexus GS 450h hybrid for \$70,000. The gross vehicle weight (GVW) of the sedan is 5,125 pounds. In 2014, Steve used this vehicle to travel 6,000 miles for business purposes and 20,000 miles total.

IRC §179 Property?	Qualifies for Bonus Depreciation?	Recovery Period?
<input type="checkbox"/> Yes <input type="checkbox"/> No	<input type="checkbox"/> Yes <input type="checkbox"/> No	_____

Problem 6

Snoopy Shimoda purchased a used Travel Air 4000, a 3-seat biplane, on August 25, 2015, for \$15,000. He used the plane to ferry passengers from Racine, Wisconsin, to Holland, Michigan.

IRC §179 Property?	Qualifies for Bonus Depreciation?	Recovery Period?
<input type="checkbox"/> Yes <input type="checkbox"/> No	<input type="checkbox"/> Yes <input type="checkbox"/> No	_____

Problem 7

DuWayne Racer built a car wash. Construction began in 2013 and was finished in January 2015 at a total cost of \$1.2 million. The grand opening was held on February 16, 2015.

IRC §179 Property?	Qualifies for Bonus Depreciation?	Recovery Period?
<input type="checkbox"/> Yes <input type="checkbox"/> No	<input type="checkbox"/> Yes <input type="checkbox"/> No	_____

Problem 8

National Parts, Inc., fabricates specialty metal components for an international equipment manufacturer. In 2014, National Parts, Inc., spent \$200,000 on dies, jigs, molds, patterns, fixtures, and gauges specifically needed to manufacture the components. These special tools cannot be adapted to a different use if the designs of the components change.

IRC §179 Property?	Qualifies for Bonus Depreciation?	Recovery Period?
<input type="checkbox"/> Yes <input type="checkbox"/> No	<input type="checkbox"/> Yes <input type="checkbox"/> No	_____

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SOLUTIONS TO PROBLEMS

Problem 1 Solution

The hydraulic hand dolly meets the requirements for IRC §179 property because it is personal property purchased for business use. The dolly does not qualify for bonus depreciation because it was purchased after December 31, 2014.

The GDS recovery period for the dolly is five years. This was determined as follows.

1. Table B-1 was reviewed, but “hydraulic hand dolly” is not specifically included.
2. The taxpayer’s business activity is professional services. “Professional services” is listed in table B-2 under “Distributive Trades and Services” (asset class 57.0).

Problem 2 Solution

The new desk purchased by Golden Ball, Inc., is qualified IRC §179 property because it is personal property purchased for business use. The desk also qualifies for 50% bonus depreciation because it is new property placed in service prior to December 31, 2014.

The recovery period for the desk is seven years. This was determined as follows.

1. Table B-1 was reviewed, and “desks” is specifically listed under the asset class 00.11. This class is assigned a 7-year recovery period under GDS.
2. The business activity is construction. “Construction activities” is listed in table B-2 under asset class 15.0. “Desks” is not listed specifically under this activity. Therefore, the recovery period from table B-1 is the one that applies.

Problem 3 Solution

The used display case is qualified IRC §179 property because it is personal property purchased for business use. However, it is not qualified for bonus depreciation because the original use of the case did not begin with this taxpayer.

The cost of the display case is recovered over five years. This was determined as follows.

1. Table B-1 was reviewed, and “display cases” is not specifically included.
2. The business activity is retail trade. “Retail trade” is listed in table B-2 under “Distributive Trades and Services” (asset class 57.0).

Problem 4 Solution

The crane purchased by Faithful Johannes, Inc., qualifies for the IRC §179 deduction because it is personal property purchased for business use. However, the amount deductible is limited because the company purchased more than \$2 million of qualifying property during the year. The actual amount of §179 deduction allowed on its 2014 tax return is calculated as follows.

Maximum allowable IRC §179 deduction for 2014 before limitation		\$500,000
Total cost of IRC §179 property placed in service in 2014	\$2,300,000	
Threshold for 2014	<u>(2,000,000)</u>	
Reduction in maximum amount allowable	(\$ 300,000)	<u>(300,000)</u>
Maximum IRC §179 deduction		\$200,000

The crane does not qualify for bonus depreciation because it was not new equipment when purchased by the company.

After taking the IRC §179 deduction, the remaining cost of the crane is depreciated over five years. This was determined as follows.

1. Table B-1 was reviewed to find that “crane” is not specifically included.
2. The business activity is construction. “Construction” is found in table B-2 (asset class 15.0). The GDS recovery period for assets used in construction activities is five years according to this table.

Problem 5 Solution

The vehicle is not qualified for the IRC §179 deduction or bonus depreciation. Passenger vehicles under 6,000 pounds GVW are included in listed property. Listed property that is not used more than 50% for business does not qualify for these provisions. Steve's business use is only 30% (6,000 business miles ÷ 20,000 total miles).

The ADS recovery period shown in table B-1 for "automobiles" (asset class 00.22) is five years. Because Steve's vehicle fails the business-use test, it must be depreciated using the straight-line method. The total deduction is also limited by the maximum depreciation deduction allowed for a passenger automobile.

Steve's 2014 depreciation deduction for the Lexus is calculated as follows.

Purchase price	\$70,000	
Divided by the recovery period	÷ 5	
	<u>\$14,000</u>	
Multiplied by 50% to apply the half-year convention	× 50%	
Straight-line deduction, half-year convention	<u>\$ 7,000</u>	
Multiplied by his business use percentage	× 30%	
Potential deduction	<u>\$ 2,100</u>	\$2,100
Maximum depreciation expense for passenger vehicles first placed in service in 2014	<u>\$ 3,160</u>	
Multiplied by his business use percentage	× 30%	
Maximum deduction	<u>\$ 948</u>	948
Lesser of the potential deduction or maximum deduction		\$ 948

Note. If Steve had used the vehicle more than 50% for business purposes, it would qualify for the IRC §179 deduction and bonus depreciation, but the total deduction for 2014 would still be capped. The cap is calculated by multiplying the business-use percentage by the passenger automobile limit of \$11,160 (which includes allowable bonus depreciation of \$8,000). For example, if Steve had driven the car 60% for business purposes, the maximum depreciation he could claim for 2014 would be \$6,696 (60% × \$11,160).

Problem 6 Solution

The Travel Air 4000 qualifies for the IRC §179 deduction because it is personal property purchased for business use. It does not qualify for bonus depreciation because the biplane is not new.

The cost of the airplane is recovered over seven years. This was determined as follows.

1. "Airplanes" are listed under asset class 00.21 in table B-1, but passenger airplanes are specifically excluded from this class.
2. In table B-2, the business activity for asset class 45.0 is "air transport." Table B-2 specifies that passenger airplanes are depreciated over seven years.

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Problem 7 Solution

The IRC §179 deduction is not available for the car wash property. It is not qualified real property (i.e., leasehold improvements, restaurant improvements, or retail improvements).

The car wash meets the following requirements to qualify for bonus depreciation.

- It is tangible property with a recovery period of less than 20 years.
- The original use began with the taxpayer.
- The contract to build the facility was in place prior to January 1, 2015.

Under current law, bonus depreciation expires on December 31, 2014. However, this property qualifies as one that has a longer production period because it meets the following conditions.⁴⁷

1. It has a recovery period of **at least** 10 years.
2. The property is subject to the capitalization provisions of IRC §263A.
3. The property's production period exceeded one year and the cost exceeded \$1 million.

However, only the costs incurred prior to January 1, 2015, qualify for bonus depreciation.⁴⁸

The recovery period for a car wash is 15 years. This was determined as follows.

1. Table B-1 was reviewed, and “car wash” is not specifically included.
2. Asset class 57.1 in table B-2 specifies that a car-wash building is depreciated over a 15-year recovery period.

Problem 8 Solution

The specialty tools qualify for the IRC §179 deduction because they are personal property purchased for business use. They also qualify for bonus depreciation because they are new assets purchased prior to January 1, 2015, that have a recovery period of 20 years or less.

The recovery period is three years. This was determined as follows.

1. Table B-1 was reviewed to find that “specialty tools” is not specifically included.
2. Asset class 34.01 in table B-2 includes specialty tools used in activities involving the “manufacture of fabricated metal products.” The GDS recovery period is three years.

⁴⁷ IRC §168(k)(2) and IRS Pub. 946, *How To Depreciate Property*.

⁴⁸ IRC §168(k)(2)(B)(ii).

Appendix B — Table of Class Lives and Recovery Periods

The *Table of Class Lives and Recovery Periods* has two sections. The first section, *Specific Depreciable Assets Used In All Business Activities, Except As Noted*, generally lists assets used in all business activities. It is shown as Table B-1. The second section, *Depreciable Assets Used In The Following Activities*, describes assets used only in certain activities. It is shown as Table B-2.

How To Use the Tables

You will need to look at both Table B-1 and B-2 to find the correct recovery period. Generally, if the property is listed in Table B-1 you use the recovery period shown in that table. However, if the property is specifically listed in Table B-2 under the type of activity in which it is used, you use the recovery period listed under the activity in that table. Use the tables in the order shown below to determine the recovery period of your depreciable property.

Table B-1. Check Table B-1 for a description of the property. If it is described in Table B-1, also check Table B-2 to find the activity in which the property is being used. If the activity is described in Table B-2, read the text (if any) under the title to determine if the property is specifically included in that asset class. If it is, use the recovery period shown in the appropriate column of Table B-2 following the description of the activity. If the activity is not described in Table B-2 or if the activity is described but the property either is not specifically included in or is specifically excluded from that asset class, then use the recovery period shown in the appropriate column following the description of the property in Table B-1.

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

Table B-2. If the property is not listed in Table B-1, check Table B-2 to find the activity in which the property is being used and use the recovery period shown in the appropriate column following the description.

Property not in either table. If the activity or the property is not included in either table, check the end of Table B-2 to find *Certain Property for Which Recovery Periods Assigned*. This property generally has a recovery period of 7 years for GDS or 12 years for ADS. See *Which Property Class Applies Under GDS* and *Which Recovery Period Applies* in chapter 4 for the class lives or the recovery periods for GDS and ADS for the following.

- Residential rental property and nonresidential real property (also see Appendix A, Chart 2).
- Qualified rent-to-own property.
- A motorsport entertainment complex placed in service before January 1, 2015.
- Any retail motor fuels outlet.
- Any qualified leasehold improvement property placed in service before January 1, 2015.
- Any qualified restaurant property placed in service before January 1, 2015.
- Initial clearing and grading land improvements for gas utility property and electric utility transmission and distribution plants.
- Any water utility property.
- Certain electric transmission property used in the transmission at 69 or more kilovolts of electricity for sale and placed in service after April 11, 2005.
- Natural gas gathering and distribution lines placed in service after April 11, 2005.

Example 1. Richard Green is a paper manufacturer. During the year, he made substantial improvements to the land on which his paper plant is located. He checks Table B-1 and finds

land improvements under asset class 00.3. He then checks Table B-2 and finds his activity, paper manufacturing, under asset class 26.1, *Manufacture of Pulp and Paper*. He uses the recovery period under this asset class because it specifically includes land improvements. The land improvements have a 13-year class life and a 7-year recovery period for GDS. If he elects to use ADS, the recovery period is 13 years. If Richard only looked at Table B-1, he would select asset class 00.3, *Land Improvements*, and incorrectly use a recovery period of 15 years for GDS or 20 years for ADS.

Example 2. Sam Plower produces rubber products. During the year, he made substantial improvements to the land on which his rubber plant is located. He checks Table B-1 and finds land improvements under asset class 00.3. He then checks Table B-2 and finds his activity, producing rubber products, under asset class 30.1, *Manufacture of Rubber Products*. Reading the headings and descriptions under asset class 30.1, Sam finds that it does not include land improvements. Therefore, Sam uses the recovery period under asset class 00.3. The land improvements have a 20-year class life and a 15-year recovery period for GDS. If he elects to use ADS, the recovery period is 20 years.

Example 3. Pam Martin owns a retail clothing store. During the year, she purchased a desk and a cash register for use in her business. She checks Table B-1 and finds office furniture under asset class 00.11. Cash registers are not listed in any of the asset classes in Table B-1. She then checks Table B-2 and finds her activity, retail store, under asset class 57.0, *Distributive Trades and Services*, which includes **assets used in wholesale and retail trade**. This asset class does not specifically list office furniture or a cash register. She looks back at Table B-1 and uses asset class 00.11 for the desk. The desk has a 10-year class life and a 7-year recovery period for GDS. If she elects to use ADS, the recovery period is 10 years. For the

cash register, she uses asset class 57.0 because cash registers are not listed in Table B-1 but it is an **asset** used in her retail business. The cash

register has a 9-year class life and a 5-year recovery period for GDS. If she

elects to use the ADS method, the recovery period is 9 years.

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Table B-1. **Table of Class Lives and Recovery Periods**

Asset class	Description of assets included	Recovery Periods (in years)		
		Class Life (in years)	GDS (MACRS)	ADS
SPECIFIC DEPRECIABLE ASSETS USED IN ALL BUSINESS ACTIVITIES, EXCEPT AS NOTED:				
00.11	Office Furniture, Fixtures, and Equipment: Includes furniture and fixtures that are not a structural component of a building. Includes such assets as desks, files, safes, and communications equipment. Does not include communications equipment that is included in other classes.	10	7	10
00.12	Information Systems: Includes computers and their peripheral equipment used in administering normal business transactions and the maintenance of business records, their retrieval and analysis. Information systems are defined as: 1) Computers: A computer is a programmable electronically activated device capable of accepting information, applying prescribed processes to the information, and supplying the results of these processes with or without human intervention. It usually consists of a central processing unit containing extensive storage, logic, arithmetic, and control capabilities. Excluded from this category are adding machines, electronic desk calculators, etc., and other equipment described in class 00.13. 2) Peripheral equipment consists of the auxiliary machines which are designed to be placed under control of the central processing unit. Nonlimiting examples are: Card readers, card punches, magnetic tape feeds, high speed printers, optical character readers, tape cassettes, mass storage units, paper tape equipment, keypunches, data entry devices, teleprinters, terminals, tape drives, disc drives, disc files, disc packs, visual image projector tubes, card sorters, plotters, and collators. Peripheral equipment may be used on-line or off-line. Does not include equipment that is an integral part of other capital equipment that is included in other classes of economic activity, i.e., computers used primarily for process or production control, switching, channeling, and automating distributive trades and services such as point of sale (POS) computer systems. Also, does not include equipment of a kind used primarily for amusement or entertainment of the user.	6	5	5
00.13	Data Handling Equipment; except Computers: Includes only typewriters, calculators, adding and accounting machines, copiers, and duplicating equipment.	6	5	6
00.21	Airplanes (airframes and engines), except those used in commercial or contract carrying of passengers or freight, and all helicopters (airframes and engines)	6	5	6
00.22	Automobiles, Taxis	3	5	5
00.23	Buses	9	5	9
00.241	Light General Purpose Trucks: Includes trucks for use over the road (actual weight less than 13,000 pounds)	4	5	5
00.242	Heavy General Purpose Trucks: Includes heavy general purpose trucks, concrete ready mix-trucks, and ore trucks, for use over the road (actual unloaded weight 13,000 pounds or more)	6	5	6
00.25	Railroad Cars and Locomotives, except those owned by railroad transportation companies	15	7	15
00.26	Tractor Units for Use Over-The-Road	4	3	4
00.27	Trailers and Trailer-Mounted Containers	6	5	6
00.28	Vessels, Barges, Tugs, and Similar Water Transportation Equipment, except those used in marine construction	18	10	18
00.3	Land Improvements: Includes improvements directly to or added to land, whether such improvements are section 1245 property or section 1250 property, provided such improvements are depreciable. Examples of such assets might include sidewalks, roads, canals, waterways, drainage facilities, sewers (not including municipal sewers in Class 51), wharves and docks, bridges, fences, landscaping shrubbery, or radio and television transmitting towers. Does not include land improvements that are explicitly included in any other class, and buildings and structural components as defined in section 1.48-1(e) of the regulations. Excludes public utility initial clearing and grading land improvements as specified in Rev. Rul. 72-403, 1972-2 C.B. 102.	20	15	20
00.4	Industrial Steam and Electric Generation and/or Distribution Systems: Includes assets, whether such assets are section 1245 property or 1250 property, providing such assets are depreciable, used in the production and/or distribution of electricity with rated total capacity in excess of 500 Kilowatts and/or assets used in the production and/or distribution of steam with rated total capacity in excess of 12,500 pounds per hour for use by the taxpayer in its industrial manufacturing process or plant activity and not ordinarily available for sale to others. Does not include buildings and structural components as defined in section 1.48-1(e) of the regulations. Assets used to generate and/or distribute electricity or steam of the type described above, but of lesser rated capacity, are not included, but are included in the appropriate manufacturing equipment classes elsewhere specified. Also includes electric generating and steam distribution assets, which may utilize steam produced by a waste reduction and resource recovery plant, used by the taxpayer in its industrial manufacturing process or plant activity. Steam and chemical recovery boiler systems used for the recovery and regeneration of chemicals used in manufacturing, with rated capacity in excess of that described above, with specifically related distribution and return systems are not included but are included in appropriate manufacturing equipment classes elsewhere specified. An example of an excluded steam and chemical recovery boiler system is that used in the pulp and paper manufacturing equipment classes elsewhere specified. An example of an excluded steam and chemical recovery boiler system is that used in the pulp and paper manufacturing industry.	22	15	22

Table B-2. Table of Class Lives and Recovery Periods

Asset class	Description of assets included	Class Life (in years)	Recovery Periods (in years)	
			GDS (MACRS)	ADS
DEPRECIABLE ASSETS USED IN THE FOLLOWING ACTIVITIES:				
01.1	Agriculture: Includes machinery and equipment, grain bins, and fences but no other land improvements, that are used in the production of crops or plants, vines, and trees; livestock; the operation of farm dairies, nurseries, greenhouses, sod farms, mushroom cellars, cranberry bogs, apiaries, and fur farms; the performance of agriculture, animal husbandry, and horticultural services.	10	7	10
01.11	Cotton Ginning Assets	12	7	12
01.21	Cattle, Breeding or Dairy	7	5	7
01.221	Any breeding or work horse that is 12 years old or less at the time it is placed in service**	10	7	10
01.222	Any breeding or work horse that is more than 12 years old at the time it is placed in service**	10	3	10
01.223	Any race horse that is more than 2 years old at the time it is placed in service**	*	3	12
01.224	Any horse that is more than 12 years old at the time it is placed in service and that is neither a race horse nor a horse described in class 01.222**	*	3	12
01.225	Any horse not described in classes 01.221, 01.222, 01.223, or 01.224	*	7	12
01.23	Hogs, Breeding	3	3	3
01.24	Sheep and Goats, Breeding	5	5	5
01.3	Farm buildings except structures included in Class 01.4	25	20	25
01.4	Single purpose agricultural or horticultural structures (within the meaning of section 168(i)(13) of the Code)	15	10***	15
10.0	Mining: Includes assets used in the mining and quarrying of metallic and nonmetallic minerals (including sand, gravel, stone, and clay) and the milling, beneficiation and other primary preparation of such materials.	10	7	10
13.0	Offshore Drilling: Includes assets used in offshore drilling for oil and gas such as floating, self-propelled and other drilling vessels, barges, platforms, and drilling equipment and support vessels such as tenders, barges, towboats and crewboats. Excludes oil and gas production assets.	7.5	5	7.5
13.1	Drilling of Oil and Gas Wells: Includes assets used in the drilling of onshore oil and gas wells and the provision of geophysical and other exploration services; and the provision of such oil and gas field services as chemical treatment, plugging and abandoning of wells and cementing or perforating well casings. Does not include assets used in the performance of any of these activities and services by integrated petroleum and natural gas producers for their own account.	6	5	6
13.2	Exploration for and Production of Petroleum and Natural Gas Deposits: Includes assets used by petroleum and natural gas producers for drilling of wells and production of petroleum and natural gas, including gathering pipelines and related storage facilities. Also includes petroleum and natural gas offshore transportation facilities used by producers and others consisting of platforms (other than drilling platforms classified in Class 13.0), compression or pumping equipment, and gathering and transmission lines to the first onshore transshipment facility. The assets used in the first onshore transshipment facility are also included and consist of separation equipment (used for separation of natural gas, liquids, and in Class 49.23), and liquid holding or storage facilities (other than those classified in Class 49.25). Does not include support vessels.	14	7	14
13.3	Petroleum Refining: Includes assets used for the distillation, fractionation, and catalytic cracking of crude petroleum into gasoline and its other components.	16	10	16
15.0	Construction: Includes assets used in construction by general building, special trade, heavy and marine construction contractors, operative and investment builders, real estate subdividers and developers, and others except railroads.	6	5	6
20.1	Manufacture of Grain and Grain Mill Products: Includes assets used in the production of flours, cereals, livestock feeds, and other grain and grain mill products.	17	10	17
20.2	Manufacture of Sugar and Sugar Products: Includes assets used in the production of raw sugar, syrup, or finished sugar from sugar cane or sugar beets.	18	10	18
20.3	Manufacture of Vegetable Oils and Vegetable Oil Products: Includes assets used in the production of oil from vegetable materials and the manufacture of related vegetable oil products.	18	10	18
20.4	Manufacture of Other Food and Kindred Products: Includes assets used in the production of foods and beverages not included in classes 20.1, 20.2 and 20.3.	12	7	12
20.5	Manufacture of Food and Beverages—Special Handling Devices: Includes assets defined as specialized materials handling devices such as returnable pallets, palletized containers, and fish processing equipment including boxes, baskets, carts, and flaking trays used in activities as defined in classes 20.1, 20.2, 20.3 and 20.4. Does not include general purpose small tools such as wrenches and drills, both hand and power-driven, and other general purpose equipment such as conveyors, transfer equipment, and materials handling devices.	4	3	4

* Property described in asset classes 01.223, 01.224, and 01.225 are assigned recovery periods but have no class lives.

** A horse is more than 2 (or 12) years old after the day that is 24 (or 144) months after its actual birthdate.

*** 7 if property was placed in service before 1989.

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Table B-2. **Table of Class Lives and Recovery Periods**

Asset class	Description of assets included	Recovery Periods (in years)		
		Class Life (in years)	GDS (MACRS)	ADS
21.0	Manufacture of Tobacco and Tobacco Products: Includes assets used in the production of cigarettes, cigars, smoking and chewing tobacco, snuff, and other tobacco products.	15	7	15
22.1	Manufacture of Knitted Goods: Includes assets used in the production of knitted and netted fabrics and lace. Assets used in yarn preparation, bleaching, dyeing, printing, and other similar finishing processes, texturing, and packaging, are elsewhere classified.	7.5	5	7.5
22.2	Manufacture of Yarn, Thread, and Woven Fabric: Includes assets used in the production of spun yarns including the preparing, blending, spinning, and twisting of fibers into yarns and threads, the preparation of yarns such as twisting, warping, and winding, the production of covered elastic yarn and thread, cordage, woven fabric, tire fabric, braided fabric, twisted jute for packaging, mattresses, pads, sheets, and industrial belts, and the processing of textile mill waste to recover fibers, flocks, and shoddies. Assets used to manufacture carpets, man-made fibers, and nonwovens, and assets used in texturing, bleaching, dyeing, printing, and other similar finishing processes, are elsewhere classified.	11	7	11
22.3	Manufacture of Carpets and Dyeing, Finishing, and Packaging of Textile Products and Manufacture of Medical and Dental Supplies: Includes assets used in the production of carpets, rugs, mats, woven carpet backing, chenille, and other tufted products, and assets used in the joining together of backing with carpet yarn or fabric. Includes assets used in washing, scouring, bleaching, dyeing, printing, drying, and similar finishing processes applied to textile fabrics, yarns, threads, and other textile goods. Includes assets used in the production and packaging of textile products, other than apparel, by creasing, forming, trimming, cutting, and sewing, such as the preparation of carpet and fabric samples, or similar joining together processes (other than the production of scrim reinforced paper products and laminated paper products) such as the sewing and folding of hosiery and panty hose, and the creasing, folding, trimming, and cutting of fabrics to produce nonwoven products, such as disposable diapers and sanitary products. Also includes assets used in the production of medical and dental supplies other than drugs and medicines. Assets used in the manufacture of nonwoven carpet backing, and hard surface floor covering such as tile, rubber, and cork, are elsewhere classified.	9	5	9
22.4	Manufacture of Textile Yarns: Includes assets used in the processing of yarns to impart bulk and/or stretch properties to the yarn. The principal machines involved are false-twist, draw, beam-to-beam, and stuffer box texturing equipment and related highspeed twisters and winders. Assets, as described above, which are used to further process man-made fibers are elsewhere classified when located in the same plant in an integrated operation with man-made fiber producing assets. Assets used to manufacture man-made fibers and assets used in bleaching, dyeing, printing, and other similar finishing processes, are elsewhere classified.	8	5	8
22.5	Manufacture of Nonwoven Fabrics: Includes assets used in the production of nonwoven fabrics, felt goods including felt hats, padding, batting, wadding, oakum, and fillings, from new materials and from textile mill waste. Nonwoven fabrics are defined as fabrics (other than reinforced and laminated composites consisting of nonwovens and other products) manufactured by bonding natural and/or synthetic fibers and/or filaments by means of induced mechanical interlocking, fluid entanglement, chemical adhesion, thermal or solvent reaction, or by combination thereof other than natural hydration bonding as occurs with natural cellulose fibers. Such means include resin bonding, web bonding, and melt bonding. Specifically includes assets used to make flocked and needle punched products other than carpets and rugs. Assets, as described above, which are used to manufacture nonwovens are elsewhere classified when located in the same plant in an integrated operation with man-made fiber producing assets. Assets used to manufacture man-made fibers and assets used in bleaching, dyeing, printing, and other similar finishing processes, are elsewhere classified.	10	7	10
23.0	Manufacture of Apparel and Other Finished Products: Includes assets used in the production of clothing and fabricated textile products by the cutting and sewing of woven fabrics, other textile products, and furs; but does not include assets used in the manufacture of apparel from rubber and leather.	9	5	9
24.1	Cutting of Timber: Includes logging machinery and equipment and roadbuilding equipment used by logging and sawmill operators and pulp manufacturers for their own account.	6	5	6
24.2	Sawing of Dimensional Stock from Logs: Includes machinery and equipment installed in permanent or well established sawmills.	10	7	10
24.3	Sawing of Dimensional Stock from Logs: Includes machinery and equipment in sawmills characterized by temporary foundations and a lack, or minimum amount, of lumberhandling, drying, and residue disposal equipment and facilities.	6	5	6
24.4	Manufacture of Wood Products, and Furniture: Includes assets used in the production of plywood, hardboard, flooring, veneers, furniture, and other wood products, including the treatment of poles and timber.	10	7	10
26.1	Manufacture of Pulp and Paper: Includes assets for pulp materials handling and storage, pulp mill processing, bleach processing, paper and paperboard manufacturing, and on-line finishing. Includes pollution control assets and all land improvements associated with the factory site or production process such as effluent ponds and canals, provided such improvements are depreciable but does not include buildings and structural components as defined in section 1.48-1(e)(1) of the regulations. Includes steam and chemical recovery boiler systems, with any rated capacity, used for the recovery and regeneration of chemicals used in manufacturing. Does not include assets used either in pulpwood logging, or in the manufacture of hardboard.	13	7	13

Table B-2. **Table of Class Lives and Recovery Periods**

Asset class	Description of assets included	Class Life (in years)	Recovery Periods (in years)	
			GDS (MACRS)	ADS
26.2	Manufacture of Converted Paper, Paperboard, and Pulp Products: Includes assets used for modification, or remanufacture of paper and pulp into converted products, such as paper coated off the paper machine, paper bags, paper boxes, cartons and envelopes. Does not include assets used for manufacture of nonwovens that are elsewhere classified.	10	7	10
27.0	Printing, Publishing, and Allied Industries: Includes assets used in printing by one or more processes, such as letter-press, lithography, gravure, or screen; the performance of services for the printing trade, such as bookbinding, typesetting, engraving, photo-engraving, and electrotyping; and the publication of newspapers, books, and periodicals.	11	7	11
28.0	Manufacture of Chemicals and Allied Products: Includes assets used to manufacture basic organic and inorganic chemicals; chemical products to be used in further manufacture, such as synthetic fibers and plastics materials; and finished chemical products. Includes assets used to further process man-made fibers, to manufacture plastic film, and to manufacture nonwoven fabrics, when such assets are located in the same plant in an integrated operation with chemical products producing assets. Also includes assets used to manufacture photographic supplies, such as film, photographic paper, sensitized photographic paper, and developing chemicals. Includes all land improvements associated with plant site or production processes, such as effluent ponds and canals, provided such land improvements are depreciable but does not include buildings and structural components as defined in section 1.48-1(e) of the regulations. Does not include assets used in the manufacture of finished rubber and plastic products or in the production of natural gas products, butane, propane, and by-products of natural gas production plants.	9.5	5	9.5
30.1	Manufacture of Rubber Products: Includes assets used for the production of products from natural, synthetic, or reclaimed rubber, gutta percha, balata, or gutta siak, such as tires, tubes, rubber footwear, mechanical rubber goods, heels and soles, flooring, and rubber sundries; and in the recapping, retreading, and rebuilding of tires.	14	7	14
30.11	Manufacture of Rubber Products—Special Tools and Devices: Includes assets defined as special tools, such as jigs, dies, mandrels, molds, lasts, patterns, specialty containers, pallets, shells; and tire molds, and accessory parts such as rings and insert plates used in activities as defined in class 30.1. Does not include tire building drums and accessory parts and general purpose small tools such as wrenches and drills, both power and hand-driven, and other general purpose equipment such as conveyors and transfer equipment.	4	3	4
30.2	Manufacture of Finished Plastic Products: Includes assets used in the manufacture of plastics products and the molding of primary plastics for the trade. Does not include assets used in the manufacture of basic plastics materials nor the manufacture of phonograph records.	11	7	11
30.21	Manufacture of Finished Plastic Products—Special Tools: Includes assets defined as special tools, such as jigs, dies, fixtures, molds, patterns, gauges, and specialty transfer and shipping devices, used in activities as defined in class 30.2. Special tools are specifically designed for the production or processing of particular parts and have no significant utilitarian value and cannot be adapted to further or different use after changes or improvements are made in the model design of the particular part produced by the special tools. Does not include general purpose small tools such as wrenches and drills, both hand and power-driven, and other general purpose equipment such as conveyors, transfer equipment, and materials handling devices.	3.5	3	3.5
31.0	Manufacture of Leather and Leather Products: Includes assets used in the tanning, currying, and finishing of hides and skins; the processing of fur pelts; and the manufacture of finished leather products, such as footwear, belting, apparel, and luggage.	11	7	11
32.1	Manufacture of Glass Products: Includes assets used in the production of flat, blown, or pressed products of glass, such as float and window glass, glass containers, glassware and fiberglass. Does not include assets used in the manufacture of lenses.	14	7	14
32.11	Manufacture of Glass Products—Special Tools: Includes assets defined as special tools such as molds, patterns, pallets, and specialty transfer and shipping devices such as steel racks to transport automotive glass, used in activities as defined in class 32.1. Special tools are specifically designed for the production or processing of particular parts and have no significant utilitarian value and cannot be adapted to further or different use after changes or improvements are made in the model design of the particular part produced by the special tools. Does not include general purpose small tools such as wrenches and drills, both hand and power-driven, and other general purpose equipment such as conveyors, transfer equipment, and materials handling devices.	2.5	3	2.5
32.2	Manufacture of Cement: Includes assets used in the production of cement, but does not include assets used in the manufacture of concrete and concrete products nor in any mining or extraction process.	20	15	20
32.3	Manufacture of Other Stone and Clay Products: Includes assets used in the manufacture of products from materials in the form of clay and stone, such as brick, tile, and pipe; pottery and related products, such as vitreous-china, plumbing fixtures, earthenware and ceramic insulating materials; and also includes assets used in manufacture of concrete and concrete products. Does not include assets used in any mining or extraction processes.	15	7	15

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Table B-2. **Table of Class Lives and Recovery Periods**

Asset class	Description of assets included	Class Life (in years)	Recovery Periods (in years)	
			GDS (MACRS)	ADS
33.2	Manufacture of Primary Nonferrous Metals: Includes assets used in the smelting, refining, and electrolysis of nonferrous metals from ore, pig, or scrap, the rolling, drawing, and alloying of nonferrous metals; the manufacture of castings, forgings, and other basic products of nonferrous metals; and the manufacture of nails, spikes, structural shapes, tubing, wire, and cable.	14	7	14
33.21	Manufacture of Primary Nonferrous Metals—Special Tools: Includes assets defined as special tools such as dies, jigs, molds, patterns, fixtures, gauges, and drawings concerning such special tools used in the activities as defined in class 33.2, Manufacture of Primary Nonferrous Metals. Special tools are specifically designed for the production or processing of particular products or parts and have no significant utilitarian value and cannot be adapted to further or different use after changes or improvements are made in the model design of the particular part produced by the special tools. Does not include general purpose small tools such as wrenches and drills, both hand and power-driven, and other general purpose equipment such as conveyors, transfer equipment, and materials handling devices. Rolls, mandrels and refractories are not included in class 33.21 but are included in class 33.2.	6.5	5	6.5
33.3	Manufacture of Foundry Products: Includes assets used in the casting of iron and steel, including related operations such as molding and coremaking. Also includes assets used in the finishing of castings and patternmaking when performed at the foundry, all special tools and related land improvements.	14	7	14
33.4	Manufacture of Primary Steel Mill Products: Includes assets used in the smelting, reduction, and refining of iron and steel from ore, pig, or scrap; the rolling, drawing and alloying of steel; the manufacture of nails, spikes, structural shapes, tubing, wire, and cable. Includes assets used by steel service centers, ferrous metal forges, and assets used in coke production, regardless of ownership. Also includes related land improvements and all special tools used in the above activities.	15	7	15
34.0	Manufacture of Fabricated Metal Products: Includes assets used in the production of metal cans, tinware, fabricated structural metal products, metal stampings, and other ferrous and nonferrous metal and wire products not elsewhere classified. Does not include assets used to manufacture non-electric heating apparatus.	12	7	12
34.01	Manufacture of Fabricated Metal Products—Special Tools: Includes assets defined as special tools such as dies, jigs, molds, patterns, fixtures, gauges, and returnable containers and drawings concerning such special tools used in the activities as defined in class 34.0. Special tools are specifically designed for the production or processing of particular machine components, products, or parts, and have no significant utilitarian value and cannot be adapted to further or different use after changes or improvements are made in the model design of the particular part produced by the special tools. Does not include general small tools such as wrenches and drills, both hand and power-driven, and other general purpose equipment such as conveyors, transfer equipment, and materials handling devices.	3	3	3
35.0	Manufacture of Electrical and Non-Electrical Machinery and Other Mechanical Products: Includes assets used to manufacture or rebuild finished machinery and equipment and replacement parts thereof such as machine tools, general industrial and special industry machinery, electrical power generation, transmission, and distribution systems, space heating, cooling, and refrigeration systems, commercial and home appliances, farm and garden machinery, construction machinery, mining and oil field machinery, internal combustion engines (except those elsewhere classified), turbines (except those that power airborne vehicles), batteries, lamps and lighting fixtures, carbon and graphite products, and electromechanical and mechanical products including business machines, instruments, watches and clocks, vending and amusement machines, photographic equipment, medical and dental equipment and appliances, and ophthalmic goods. Includes assets used by manufacturers or rebuilders of such finished machinery and equipment in activities elsewhere classified such as the manufacture of castings, forgings, rubber and plastic products, electronic subassemblies or other manufacturing activities if the interim products are used by the same manufacturer primarily in the manufacture, assembly, or rebuilding of such finished machinery and equipment. Does not include assets used in mining, assets used in the manufacture of primary ferrous and nonferrous metals, assets included in class 00.11 through 00.4 and assets elsewhere classified.	10	7	10
36.0	Manufacture of Electronic Components, Products, and Systems: Includes assets used in the manufacture of electronic communication, computation, instrumentation and control system, including airborne applications; also includes assets used in the manufacture of electronic products such as frequency and amplitude modulated transmitters and receivers, electronic switching stations, television cameras, video recorders, record players and tape recorders, computers and computer peripheral machines, and electronic instruments, watches, and clocks; also includes assets used in the manufacture of components, provided their primary use is products and systems defined above such as electron tubes, capacitors, coils, resistors, printed circuit substrates, switches, harness cables, lasers, fiber optic devices, and magnetic media devices. Specifically excludes assets used to manufacture electronic products and components, photocopiers, typewriters, postage meters and other electromechanical and mechanical business machines and instruments that are elsewhere classified. Does not include semiconductor manufacturing equipment included in class 36.1.	6	5	6
36.1	Any Semiconductor Manufacturing Equipment	5	5	5

Table B-2. **Table of Class Lives and Recovery Periods**

Asset class	Description of assets included	Class Life (in years)	Recovery Periods (in years)	
			GDS (MACRS)	ADS
37.11	Manufacture of Motor Vehicles: Includes assets used in the manufacture and assembly of finished automobiles, trucks, trailers, motor homes, and buses. Does not include assets used in mining, printing and publishing, production of primary metals, electricity, or steam, or the manufacture of glass, industrial chemicals, batteries, or rubber products, which are classified elsewhere. Includes assets used in manufacturing activities elsewhere classified other than those excluded above, where such activities are incidental to and an integral part of the manufacture and assembly of finished motor vehicles such as the manufacture of parts and subassemblies of fabricated metal products, electrical equipment, textiles, plastics, leather, and foundry and forging operations. Does not include any assets not classified in manufacturing activity classes, e.g., does not include any assets classified in asset guideline classes 00.11 through 00.4. Activities will be considered incidental to the manufacture and assembly of finished motor vehicles only if 75 percent or more of the value of the products produced under one roof are used for the manufacture and assembly of finished motor vehicles. Parts that are produced as a normal replacement stock complement in connection with the manufacture and assembly of finished motor vehicles are considered used for the manufacture assembly of finished motor vehicles. Does not include assets used in the manufacture of component parts if these assets are used by taxpayers not engaged in the assembly of finished motor vehicles.	12	7	12
37.12	Manufacture of Motor Vehicles—Special Tools: Includes assets defined as special tools, such as jigs, dies, fixtures, molds, patterns, gauges, and specialty transfer and shipping devices, owned by manufacturers of finished motor vehicles and used in qualified activities as defined in class 37.11. Special tools are specifically designed for the production or processing of particular motor vehicle components and have no significant utilitarian value, and cannot be adapted to further or different use, after changes or improvements are made in the model design of the particular part produced by the special tools. Does not include general purpose small tools such as wrenches and drills, both hand and powerdriven, and other general purpose equipment such as conveyors, transfer equipment, and materials handling devices.	3	3	3
37.2	Manufacture of Aerospace Products: Includes assets used in the manufacture and assembly of airborne vehicles and their component parts including hydraulic, pneumatic, electrical, and mechanical systems. Does not include assets used in the production of electronic airborne detection, guidance, control, radiation, computation, test, navigation, and communication equipment or the components thereof.	10	7	10
37.31	Ship and Boat Building Machinery and Equipment: Includes assets used in the manufacture and repair of ships, boats, caissons, marine drilling rigs, and special fabrications not included in asset classes 37.32 and 37.33. Specifically includes all manufacturing and repairing machinery and equipment, including machinery and equipment used in the operation of assets included in asset class 37.32. Excludes buildings and their structural components.	12	7	12
37.32	Ship and Boat Building Dry Docks and Land Improvements: Includes assets used in the manufacture and repair of ships, boats, caissons, marine drilling rigs, and special fabrications not included in asset classes 37.31 and 37.33. Specifically includes floating and fixed dry docks, ship basins, graving docks, shipways, piers, and all other land improvements such as water, sewer, and electric systems. Excludes buildings and their structural components.	16	10	16
37.33	Ship and Boat Building—Special Tools: Includes assets defined as special tools such as dies, jigs, molds, patterns, fixtures, gauges, and drawings concerning such special tools used in the activities defined in classes 37.31 and 37.32. Special tools are specifically designed for the production or processing of particular machine components, products, or parts, and have no significant utilitarian value and cannot be adapted to further or different use after changes or improvements are made in the model design of the particular part produced by the special tools. Does not include general purpose small tools such as wrenches and drills, both hand and power-driven, and other general purpose equipment such as conveyors, transfer equipment, and materials handling devices.	6.5	5	6.5
37.41	Manufacture of Locomotives: Includes assets used in building or rebuilding railroad locomotives (including mining and industrial locomotives). Does not include assets of railroad transportation companies or assets of companies which manufacture components of locomotives but do not manufacture finished locomotives.	11.5	7	11.5
37.42	Manufacture of Railroad Cars: Includes assets used in building or rebuilding railroad freight or passenger cars (including rail transit cars). Does not include assets of railroad transportation companies or assets of companies which manufacture components of railroad cars but do not manufacture finished railroad cars.	12	7	12
39.0	Manufacture of Athletic, Jewelry, and Other Goods: Includes assets used in the production of jewelry; musical instruments; toys and sporting goods; motion picture and television films and tapes; and pens, pencils, office and art supplies, brooms, brushes, caskets, etc. Railroad Transportation: Classes with the prefix 40 include the assets identified below that are used in the commercial and contract carrying of passengers and freight by rail. Assets of electrified railroads will be classified in a manner corresponding to that set forth below for railroads not independently operated as electric lines. Excludes the assets included in classes with the prefix beginning 00.1 and 00.2 above, and also excludes any non-depreciable assets included in Interstate Commerce Commission accounts enumerated for this class.	12	7	12

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Table B-2. Table of Class Lives and Recovery Periods

Asset class	Description of assets included	Recovery Periods (in years)		
		Class Life (in years)	GDS (MACRS)	ADS
40.1	Railroad Machinery and Equipment: Includes assets classified in the following Interstate Commerce Commission accounts: Roadway accounts: (16) Station and office buildings (freight handling machinery and equipment only) (25) TOFC/COFC terminals (freight handling machinery and equipment only) (26) Communication systems (27) Signals and interlockers (37) Roadway machines (44) Shop machinery Equipment accounts: (52) Locomotives (53) Freight train cars (54) Passenger train cars (57) Work equipment	14	7	14
40.2	Railroad Structures and Similar Improvements: Includes assets classified in the following Interstate Commerce Commission road accounts: (6) Bridges, trestles, and culverts (7) Elevated structures (13) Fences, snowsheds, and signs (16) Station and office buildings (stations and other operating structures only) (17) Roadway buildings (18) Water stations (19) Fuel stations (20) Shops and enginehouses (25) TOFC/COFC terminals (operating structures only) (31) Power transmission systems (35) Miscellaneous structures (39) Public improvements construction	30	20	30
40.3	Railroad Wharves and Docks: Includes assets classified in the following Interstate Commission Commerce accounts: (23) Wharves and docks (24) Coal and ore wharves	20	15	20
40.4	Railroad Track	10	7	10
40.51	Railroad Hydraulic Electric Generating Equipment	50	20	50
40.52	Railroad Nuclear Electric Generating Equipment	20	15	20
40.53	Railroad Steam Electric Generating Equipment	28	20	28
40.54	Railroad Steam, Compressed Air, and Other Power Plan Equipment	28	20	28
41.0	Motor Transport—Passengers: Includes assets used in the urban and interurban commercial and contract carrying of passengers by road, except the transportation assets included in classes with the prefix 00.2.	8	5	8
42.0	Motor Transport—Freight: Includes assets used in the commercial and contract carrying of freight by road, except the transportation assets included in classes with the prefix 00.2.	8	5	8
44.0	Water Transportation: Includes assets used in the commercial and contract carrying of freight and passengers by water except the transportation assets included in classes with the prefix 00.2. Includes all related land improvements.	20	15	20
45.0	Air Transport: Includes assets (except helicopters) used in commercial and contract carrying of passengers and freight by air. For purposes of section 1.167(a)-11(d)(2)(iv)(a) of the regulations, expenditures for “repair, maintenance, rehabilitation, or improvement,” shall consist of direct maintenance expenses (irrespective of airworthiness provisions or charges) as defined by Civil Aeronautics Board uniform accounts 5200, maintenance burden (exclusive of expenses pertaining to maintenance buildings and improvements) as defined by Civil Aeronautics Board accounts 5300, and expenditures which are not “excluded additions” as defined in section 1.167(a)-11(d)(2)(vi) of the regulations and which would be charged to property and equipment accounts in the Civil Aeronautics Board uniform system of accounts.	12	7	12
45.1	Air Transport (restricted): Includes each asset described in the description of class 45.0 which was held by the taxpayer on April 15, 1976, or is acquired by the taxpayer pursuant to a contract which was, on April 15, 1976, and at all times thereafter, binding on the taxpayer. This criterion of classification based on binding contract concept is to be applied in the same manner as under the general rules expressed in section 49(b)(1), (4), (5) and (8) of the Code (as in effect prior to its repeal by the Revenue Act of 1978, section 312(c)(1), (d), 1978-3 C.B. 1, 60).	6	5	6
46.0	Pipeline Transportation: Includes assets used in the private, commercial, and contract carrying of petroleum, gas and other products by means of pipes and conveyors. The trunk lines and related storage facilities of integrated petroleum and natural gas producers are included in this class. Excludes initial clearing and grading land improvements as specified in Rev. Rul. 72-403, 1972-2; C.B. 102, but includes all other related land improvements.	22	15	22

Table B-2. Table of Class Lives and Recovery Periods

Asset class	Description of assets included	Class Life (in years)	Recovery Periods (in years)	
			GDS (MACRS)	ADS
48.11	Telephone Communications: Includes the assets classified below and that are used in the provision of commercial and contract telephonic services such as: Telephone Central Office Buildings: Includes assets intended to house central office equipment, as defined in Federal Communications Commission Part 31 Account No. 212 whether section 1245 or section 1250 property.	45	20	45
48.12	Telephone Central Office Equipment: Includes central office switching and related equipment as defined in Federal Communications Commission Part 31 Account No. 221. Does not include computer-based telephone central office switching equipment included in class 48.121. Does not include private branch exchange (PBX) equipment.	18	10	18
48.121	Computer-based Telephone Central Office Switching Equipment: Includes equipment whose functions are those of a computer or peripheral equipment (as defined in section 168(i)(2)(B) of the Code) used in its capacity as telephone central office equipment. Does not include private exchange (PBX) equipment.	9.5	5	9.5
48.13	Telephone Station Equipment: Includes such station apparatus and connections as teletypewriters, telephones, booths, private exchanges, and comparable equipment as defined in Federal Communications Commission Part 31 Account No. 231, 232, and 234.	10	7*	10*
48.14	Telephone Distribution Plant: Includes such assets as pole lines, cable, aerial wire, underground conduits, and comparable equipment, and related land improvements as defined in Federal Communications Commission Part 31 Account Nos. 241, 242.1, 242.2, 242.3, 242.4, 243, and 244.	24	15	24
48.2	Radio and Television Broadcastings: Includes assets used in radio and television broadcasting, except transmitting towers. Telegraph, Ocean Cable, and Satellite Communications (TOCSC) includes communications-related assets used to provide domestic and international radio-telegraph, wire-telegraph, ocean-cable, and satellite communications services; also includes related land improvements. If property described in Classes 48.31–48.45 is comparable to telephone distribution plant described in Class 48.14 and used for 2-way exchange of voice and data communication which is the equivalent of telephone communication, such property is assigned a class life of 24 years under this revenue procedure. Comparable equipment does not include cable television equipment used primarily for 1-way communication.	6	5	6
48.31	TOCSC—Electric Power Generating and Distribution Systems: Includes assets used in the provision of electric power by generation, modulation, rectification, channelization, control, and distribution. Does not include these assets when they are installed on customers premises.	19	10	19
48.32	TOCSC—High Frequency Radio and Microwave Systems: Includes assets such as transmitters and receivers, antenna supporting structures, antennas, transmission lines from equipment to antenna, transmitter cooling systems, and control and amplification equipment. Does not include cable and long-line systems.	13	7	13
48.33	TOCSC—Cable and Long-line Systems: Includes assets such as transmission lines, pole lines, ocean cables, buried cable and conduit, repeaters, repeater stations, and other related assets. Does not include high frequency radio or microwave systems.	26.5	20	26.5
48.34	TOCSC—Central Office Control Equipment: Includes assets for general control, switching, and monitoring of communications signals including electromechanical switching and channeling apparatus, multiplexing equipment patching and monitoring facilities, in-house cabling, teleprinter equipment, and associated site improvements.	16.5	10	16.5
48.35	TOCSC—Computerized Switching, Channeling, and Associated Control Equipment: Includes central office switching computers, interfacing computers, other associated specialized control equipment, and site improvements.	10.5	7	10.5
48.36	TOCSC—Satellite Ground Segment Property: Includes assets such as fixed earth station equipment, antennas, satellite communications equipment, and interface equipment used in satellite communications. Does not include general purpose equipment or equipment used in satellite space segment property.	10	7	10
48.37	TOCSC—Satellite Space Segment Property: Includes satellites and equipment used for telemetry, tracking, control, and monitoring when used in satellite communications.	8	5	8
48.38	TOCSC—Equipment Installed on Customer's Premises: Includes assets installed on customer's premises, such as computers, terminal equipment, power generation and distribution systems, private switching center, teleprinters, facsimile equipment and other associated and related equipment.	10	7	10
48.39	TOCSC—Support and Service Equipment: Includes assets used to support but not engage in communications. Includes store, warehouse and shop tools, and test and laboratory assets. Cable Television (CATV): Includes communications-related assets used to provide cable television community antenna television services. Does not include assets used to provide subscribers with two-way communications services.	13.5	7	13.5

* Property described in asset guideline class 48.13 which is qualified technological equipment as defined in section 168(i)(2) is assigned a 5-year recovery period.

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Table B-2. **Table of Class Lives and Recovery Periods**

Asset class	Description of assets included	Class Life (in years)	Recovery Periods (in years)	
			GDS (MACRS)	ADS
48.41	CATV—Headend: Includes assets such as towers, antennas, preamplifiers, converters, modulation equipment, and program non-duplication systems. Does not include headend buildings and program origination assets.	11	7	11
48.42	CATV—Subscriber Connection and Distribution Systems: Includes assets such as trunk and feeder cable, connecting hardware, amplifiers, power equipment, passive devices, directional taps, pedestals, pressure taps, drop cables, matching transformers, multiple set connector equipment, and convertors.	10	7	10
48.43	CATV—Program Origination: Includes assets such as cameras, film chains, video tape recorders, lighting, and remote location equipment excluding vehicles. Does not include buildings and their structural components.	9	5	9
48.44	CATV—Service and Test: Includes assets such as oscilloscopes, field strength meters, spectrum analyzers, and cable testing equipment, but does not include vehicles.	8.5	5	8.5
48.45	CATV—Microwave Systems: Includes assets such as towers, antennas, transmitting and receiving equipment, and broad band microwave assets is used in the provision of cable television services. Does not include assets used in the provision of common carrier services.	9.5	5	9.5
49.11	Electric, Gas, Water and Steam, Utility Services: Includes assets used in the production, transmission and distribution of electricity, gas, steam, or water for sale including related land improvements. Electric Utility Hydraulic Production Plant: Includes assets used in the hydraulic power production of electricity for sale, including related land improvements, such as dams, flumes, canals, and waterways.	50	20	50
49.12	Electric Utility Nuclear Production Plant: Includes assets used in the nuclear power production and electricity for sale and related land improvements. Does not include nuclear fuel assemblies.	20	15	20
49.121	Electric Utility Nuclear Fuel Assemblies: Includes initial core and replacement core nuclear fuel assemblies (i.e., the composite of fabricated nuclear fuel and container) when used in a boiling water, pressurized water, or high temperature gas reactor used in the production of electricity. Does not include nuclear fuel assemblies used in breeder reactors.	5	5	5
49.13	Electric Utility Steam Production Plant: Includes assets used in the steam power production of electricity for sale, combustion turbines operated in a combined cycle with a conventional steam unit and related land improvements. Also includes package boilers, electric generators and related assets such as electricity and steam distribution systems as used by a waste reduction and resource recovery plant if the steam or electricity is normally for sale to others.	28	20	28
49.14	Electric Utility Transmission and Distribution Plant: Includes assets used in the transmission and distribution of electricity for sale and related land improvements. Excludes initial clearing and grading land improvements as specified in Rev. Rul. 72-403, 1972-2 C.B. 102.	30	20	30
49.15	Electric Utility Combustion Turbine Production Plant: Includes assets used in the production of electricity for sale by the use of such prime movers as jet engines, combustion turbines, diesel engines, gasoline engines, and other internal combustion engines, their associated power turbines and/or generators, and related land improvements. Does not include combustion turbines operated in a combined cycle with a conventional steam unit.	20	15	20
49.21	Gas Utility Distribution Facilities: Includes gas water heaters and gas conversion equipment installed by utility on customers' premises on a rental basis.	35	20	35
49.221	Gas Utility Manufactured Gas Production Plants: Includes assets used in the manufacture of gas having chemical and/or physical properties which do not permit complete interchangeability with domestic natural gas. Does not include gas-producing systems and related systems used in waste reduction and resource recovery plants which are elsewhere classified.	30	20	30
49.222	Gas Utility Substitute Natural Gas (SNG) Production Plant (naphtha or lighter hydrocarbon feedstocks): Includes assets used in the catalytic conversion of feedstocks or naphtha or lighter hydrocarbons to a gaseous fuel which is completely interchangeable with domestic natural gas.	14	7	14
49.223	Substitute Natural Gas—Coal Gasification: Includes assets used in the manufacture and production of pipeline quality gas from coal using the basic Lurgi process with advanced methanation. Includes all process plant equipment and structures used in this coal gasification process and all utility assets such as cooling systems, water supply and treatment facilities, and assets used in the production and distribution of electricity and steam for use by the taxpayer in a gasification plant and attendant coal mining site processes but not for assets used in the production and distribution of electricity and steam for sale to others. Also includes all other related land improvements. Does not include assets used in the direct mining and treatment of coal prior to the gasification process itself.	18	10	18
49.23	Natural Gas Production Plant	14	7	14
49.24	Gas Utility Trunk Pipelines and Related Storage Facilities: Excluding initial clearing and grading land improvements as specified in Rev. Rul. 72-40.	22	15	22
49.25	Liquefied Natural Gas Plant: Includes assets used in the liquefaction, storage, and regasification of natural gas including loading and unloading connections, instrumentation equipment and controls, pumps, vaporizers and odorizers, tanks, and related land improvements. Also includes pipeline interconnections with gas transmission lines and distribution systems and marine terminal facilities.	22	15	22

Table B-2. Table of Class Lives and Recovery Periods

Asset class	Description of assets included	Recovery Periods (in years)		
		Class Life (in years)	GDS (MACRS)	ADS
49.3	Water Utilities: Includes assets used in the gathering, treatment, and commercial distribution of water.	50	20***	50
49.4	Central Steam Utility Production and Distribution: Includes assets used in the production and distribution of steam for sale. Does not include assets used in waste reduction and resource recovery plants which are elsewhere classified.	28	20	28
49.5	Waste Reduction and Resource Recovery Plants: Includes assets used in the conversion of refuse or other solid waste or biomass to heat or to a solid, liquid, or gaseous fuel. Also includes all process plant equipment and structures at the site used to receive, handle, collect, and process refuse or other solid waste or biomass in a waterwall, combustion system, oil or gas pyrolysis system, or refuse derived fuel system to create hot water, gas, steam and electricity. Includes material recovery and support assets used in refuse or solid refuse or solid waste receiving, collecting, handling, sorting, shredding, classifying, and separation systems. Does not include any package boilers, or electric generators and related assets such as electricity, hot water, steam and manufactured gas production plants classified in classes 00.4, 49.13, 49.221, and 49.4. Does include, however, all other utilities such as water supply and treatment facilities, ash handling and other related land improvements of a waste reduction and resource recovery plant.	10	7	10
50.	Municipal Wastewater Treatment Plant	24	15	24
51.	Municipal Sewer	50	20***	50
57.0	Distributive Trades and Services: Includes assets used in wholesale and retail trade, and personal and professional services. Includes section 1245 assets used in marketing petroleum and petroleum products.	9	5	9*
57.1	Distributive Trades and Services—Billboard, Service Station Buildings and Petroleum Marketing Land Improvements: Includes section 1250 assets, including service station buildings and depreciable land improvements, whether section 1245 property or section 1250 property, used in the marketing of petroleum and petroleum products, but not including any of these facilities related to petroleum and natural gas trunk pipelines. Includes car wash buildings and related land improvements. Includes billboards, whether such assets are section 1245 property or section 1250 property. Excludes all other land improvements, buildings and structural components as defined in section 1.48-1(e) of the regulations. See <i>Gas station convenience stores</i> in chapter 3.	20	15	20
79.0	Recreation: Includes assets used in the provision of entertainment services on payment of a fee or admission charge, as in the operation of bowling alleys, billiard and pool establishments, theaters, concert halls, and miniature golf courses. Does not include amusement and theme parks and assets which consist primarily of specialized land improvements or structures, such as golf courses, sports stadia, race tracks, ski slopes, and buildings which house the assets used in entertainment services.	10	7	10
80.0	Theme and Amusement Parks: Includes assets used in the provision of rides, attractions, and amusements in activities defined as theme and amusement parks, and includes appurtenances associated with a ride, attraction, amusement or theme setting within the park such as ticket booths, facades, shop interiors, and props, special purpose structures, and buildings other than warehouses, administration buildings, hotels, and motels. Includes all land improvements for or in support of park activities (e.g., parking lots, sidewalks, waterways, bridges, fences, landscaping, etc.), and support functions (e.g., food and beverage retailing, souvenir vending and other nonlodging accommodations) if owned by the park and provided exclusively for the benefit of park patrons. Theme and amusement parks are defined as combinations of amusements, rides, and attractions which are permanently situated on park land and open to the public for the price of admission. This guideline class is a composite of all assets used in this industry except transportation equipment (general purpose trucks, cars, airplanes, etc.), which are included in asset guideline classes with the prefix 00.2), assets used in the provision of administrative services (asset classes with the prefix 00.1) and warehouses, administration buildings, hotels and motels.	12.5	7	12.5
	Certain Property for Which Recovery Periods Assigned			
	A. Personal Property With No Class Life Section 1245 Real Property With No Class Life		7 7	12 40
	B. Qualified Technological Equipment, as defined in section 168(i)(2).	**	5	5
	C. Property Used in Connection with Research and Experimentation referred to in section 168(e)(3)(B).	**	5	class life if no class life—12
	D. Alternative energy property described in sections 48(l)(3)(A)(ix) (as in effect on the day before the date of enactment (11/5/90) of the Revenue Reconciliation Act of 1990).	**	5	class life if no class life—12
	E. Biomass property described in section 48(l)(15) (as in effect on the day before the date of enactment (11/5/90) of the Revenue Reconciliation Act of 1990) and is a qualifying small production facility within the meaning of section 3(17)(c) of the Federal Power Act (16 U.S.C. 796(17)(C)), as in effect on September 1, 1986.	**	5	class life if no class life—12
	F. Energy property described in section 48(a)(3)(A) (or would be described if “solar or wind energy” were substituted for “solar energy” in section 48(a)(3)(A)(i)).	**	5	class life if no class life—12

* Any high technology medical equipment as defined in section 168(i)(2)(C) which is described in asset guideline class 57.0 is assigned a 5-year recovery period for the alternate MACRS method.

** The class life (if any) of property described in classes B, C, D, E, or F is determined by reference to the asset guideline classes. If an item of property described in paragraphs B, C, D, E, or F is not described in any asset guideline class, such item of property has no class life.

*** Use straight line over 25 years if placed in service after June 12, 1996, unless placed in service under a binding contract in effect before June 10, 1996, and at all times until placed in service.

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