

taxation and which is a tax-exempt entity as defined in section 168(h)(2). On the same date, Z owns an aircraft (DA) with a fair market value of \$1 million, which has been, and continues to be, leased to an airline that is a United States taxpayer. Z's adjusted basis in DA is \$0. The next day, at a time when each aircraft is still worth \$1 million, B transfers FA to Z (subject to the lease to the foreign airline) in exchange for DA (subject to the lease to the airline that is a United States taxpayer). Z realizes gain of \$1 million on the exchange, but that gain is not recognized pursuant to section 1031(a) because the exchange is of like-kind properties. Assume that a principal purpose of the transfer of DA to B or of FA to Z is to avoid the application of the alternative depreciation system. Following the exchange, Z has a \$0 basis in FA pursuant to section 1031(d). B has a \$1 million basis in DA.

(ii) B has acquired property from Z, a related person; Z's gain is not recognized pursuant to section 1031(a); Z has received tax-exempt use property as part of the transaction; and a principal purpose of the transfer of DA to B or of FA to Z is to avoid the application of the alternative depreciation system. Accordingly, the transaction is within the scope of this section. Pursuant to paragraph (b) of this section, B must recover its \$1 million basis in DA over the remaining recovery period of, and using the same depreciation method and convention as that of, FA, the related tax-exempt use property.

(iii) If FA did not become tax-exempt use property until after the exchange, it would still be related tax-exempt use property and paragraph (b) of this section would apply if, at the time of the exchange, it was intended that FA become tax-exempt use property.

Example 2. (i) X owns all of the stock of two subsidiaries, B and Z. X, B and Z do not file a consolidated federal income tax return. B and Z each own identical aircraft. B's aircraft (FA) is leased to a tax-exempt entity as defined in section 168(h)(2) and has a fair market value of \$1 million and an adjusted basis of \$500,000. Z's aircraft (DA) is leased to a United States taxpayer and has a fair market value of \$1 million and an adjusted basis of \$10,000. On May 1, 1995, B and Z exchange aircraft, subject to their respective leases. B realizes gain of \$500,000 and Z realizes gain of \$990,000, but neither person recognizes gain because of the operation of section 1031(a). Moreover, assume that a principal purpose of the transfer of DA to B or of FA to Z is to avoid the application of the alternative depreciation system.

(ii) As in *Example 1*, B has acquired property from Z, a related person; Z's gain is not recognized pursuant to section 1031(a); Z has received tax-exempt use property as part of the transaction; and a principal purpose of the transfer of DA to B or of FA to Z is to avoid the application of the alternative de-

preciation system. Thus, the transaction is within the scope of this section even though B has held tax-exempt use property for a period of time and, during that time, has used the alternative depreciation system with respect to such property. Pursuant to paragraph (b) of this section, B, which has a substituted basis determined pursuant to section 1031(d) of \$500,000 in DA, must depreciate the aircraft over the remaining recovery period of FA, using the same depreciation method and convention. Z holds tax-exempt use property with a basis of \$10,000, which must be depreciated under the alternative depreciation system.

(iii) Assume the same facts as in paragraph (i) of this *Example 2*, except that B and Z are members of an affiliated group that files a consolidated federal income tax return. Of B's \$500,000 basis in DA, \$10,000 is subject to section 168(i)(7) and therefore not subject to this section. The remaining \$490,000 of basis is subject to this section. But see § 1.1502-80(f) making section 1031 inapplicable to intercompany transactions occurring in consolidated return years beginning on or after July 12, 1995.

(e) *Effective date.* This section applies to transfers made on or after April 20, 1995.

[T.D. 8667, 61 FR 18676, Apr. 29, 1996]

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[T.D. 8566, 59 FR 51371, Oct. 11, 1994]

§ 1.168(i)-1 General asset accounts.

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

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

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

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

(3) *Adjusted depreciable basis of the general asset account* is the unadjusted

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

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

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

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

(B) A general asset account shall be treated as a single asset for purposes of applying the rules in § 1.861-9T(g)(3)