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APR 25 2016

Honorable Ron Wyden
United States Senate
SD-221
Washington, D.C. 20510

Dear Senator Wyden:

This letter is in response to your request for a technical explanation of your discussion draft (MCG16203) to modify rules relating to cost recovery, the “Cost Recovery Reform and Simplification Act of 2016.” The enclosed document, prepared by the staff of the Joint Committee on Taxation, provides such technical explanation.

I hope this information is helpful to you. If we can be of further assistance in this matter, please let me know.

Sincerely,


Thomas A. Barthold

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DESCRIPTION OF THE COST RECOVERY REFORM AND SIMPLIFICATION ACT OF 2016¹

I. PRESENT LAW

A. Cost Recovery

Overview

For Federal income tax purposes, a taxpayer is allowed to recover through annual depreciation deductions the cost of certain property used in a trade or business or for the production of income.² Under the modified accelerated cost recovery system (“MACRS”), adopted in 1986, the amount of the depreciation deduction allowed with respect to tangible property for a taxable year is determined for different types of property based on an assigned applicable depreciation method, recovery period, and convention.³

Recovery periods and depreciation methods

The applicable recovery period for an asset is determined in part by statute and in part by historic Treasury guidance.⁴ The “type of property” of an asset is used to determine the “class life” of the asset, which in turn dictates the applicable recovery period for the asset.

The MACRS recovery periods applicable to most tangible personal property range from three to 20 years. The depreciation methods generally applicable to tangible personal property are the 200-percent and 150-percent declining balance methods,⁵ switching to the straight line

¹ This document provides a description of the Cost Recovery Reform and Simplification Act of 2016, a discussion draft prepared by Senate Committee on Finance Ranking Member’s staff to modify rules relating to cost recovery, released April 25, 2016 (the “discussion draft”).

² Sec. 167(a). However, where property is not used exclusively in a taxpayer’s business, the amount eligible for a deduction must be reduced by the amount related to personal use. See, e.g., section 280A.

³ The Tax Reform Act of 1986, Pub. L. No. 99-514, sec. 201 (1986).

⁴ Exercising authority granted by Congress, the Secretary issued Rev. Proc. 87-56 (1987-2 C.B. 674), laying out the framework of recovery periods for enumerated classes of assets. The Secretary clarified and modified the list of asset classes in Rev. Proc. 88-22 (1988-1 C.B. 785). In November 1988, Congress revoked the Secretary’s authority to modify the class lives of depreciable property. Rev. Proc. 87-56, as modified, remains in effect except to the extent that the Congress has, since 1988, statutorily modified the recovery period for certain depreciable assets, effectively superseding any administrative guidance with regard to such property.

⁵ Under the declining balance method the depreciation rate is determined by dividing the appropriate percentage (here 150 or 200) by the appropriate recovery period. This leads to accelerated depreciation when the declining balance percentage is greater than 100. The table below illustrates depreciation for an asset with a cost of

method for the first taxable year where using the straight line method with respect to the adjusted basis as of the beginning of that year yields a larger depreciation allowance. The recovery periods for most real property are 39 years for nonresidential real property and 27.5 years for residential rental property. The straight line depreciation method is required for the aforementioned real property. Table 1 provides general rules for class lives and recovery periods as provided in section 168(c) and (e).

Table 1.—General Rules for Class Lives and Recovery Periods

Type of Property	General Rule – Class Life	MACRS Applicable Recovery Period
3-year property	4 years or less	3 years
5-year property	More than 4 but less than 10 years	5 years
7-year property	10 or more but less than 16 years; also, property (other than real property) without a class life	7 years
10-year property	16 or more but less than 20 years	10 years
15-year property	20 or more but less than 25 years	15 years
20-year property	25 or more years	20 years
Water utility property	50 years	25 years
Residential rental property	40 years	27.5 years
Nonresidential real property	40 years	39 years
Any railroad grading or tunnel bore	50 years	50 years

Placed-in-service conventions

\$1,000 and a seven-year recovery period under the 200-percent declining balance method, the 150-percent declining balance method, and the straight line method.

Recovery method	Year 1	Year 2	Year 3	Year 4	Year 5	Year 6	Year 7	Total
200-percent declining balance	285.71	204.08	145.77	104.12	86.77	86.77	86.77	1,000.00
150-percent declining balance	214.29	168.37	132.29	121.26	121.26	121.26	121.26	1,000.00
Straight-line	142.86	142.86	142.86	142.86	142.86	142.86	142.86	1,000.00

Depreciation of an asset begins when the asset is deemed to be placed in service under the applicable convention.⁶ Under MACRS, nonresidential real property, residential rental property, and any railroad grading or tunnel bore generally are subject to the mid-month convention, which treats all property placed in service during any month (or disposed of during any month) as placed in service (or disposed of) on the mid-point of such month.⁷ All other property generally is subject to the half-year convention, which treats all property placed in service during any taxable year (or disposed of during any taxable year) as placed in service (or disposed of) on the mid-point of such taxable year to reflect the assumption that assets are placed in service ratably throughout the year.⁸ However, if substantial property is placed in service during the last three months of a taxable year, a special rule requires use of the mid-quarter convention,⁹ designed to prevent the recognition of disproportionately large amounts of first-year depreciation under the half-year convention.

Alternative depreciation system

The alternative depreciation system (“ADS”) is required to be used for property used predominantly outside the United States, tax-exempt bond financed property, and certain tax-exempt use property.¹⁰ An election to use ADS is available to taxpayers for any class of property for any taxable year.¹¹ Under ADS, all property is depreciated using the straight line method over recovery periods which generally are equal to the class life of the property, with certain exceptions.¹²

Business property on an Indian reservation

With respect to certain property used in connection with the conduct of a trade or business within an Indian reservation, depreciation deductions under section 168(j) are determined using accelerated recovery periods (detailed in Table 2).

⁶ Treas. Reg. sec. 1.167(a)-10(b).

⁷ Sec. 168(d)(2) and (d)(4)(B).

⁸ Sec. 168(d)(1) and (d)(4)(A).

⁹ The mid-quarter convention treats all property placed in service (or disposed of) during any quarter as placed in service (or disposed of) on the mid-point of such quarter. Sec. 168(d)(3) and (d)(4)(C).

¹⁰ Sec. 168(g).

¹¹ Sec. 168(g)(7).

¹² Sec. 168(g)(2).

Table 2.— Recovery Periods for Indian Reservation Property

Type of Property ¹³	MACRS Applicable Recovery Period
3-year property	2 years
5-year property	3 years
7-year property	4 years
10-year property	6 years
15-year property	9 years
20-year property	12 years
Nonresidential real property	22 years

“Qualified Indian reservation property” eligible for accelerated depreciation includes property described in the table above which is: (1) used by the taxpayer predominantly in the active conduct of a trade or business within an Indian reservation; (2) not used or located outside the reservation on a regular basis; (3) not acquired (directly or indirectly) by the taxpayer from a person who is related to the taxpayer;¹⁴ and (4) is not property placed in service for purposes of conducting gaming activities.¹⁵ Certain “qualified infrastructure property” may be eligible for the accelerated depreciation even if located outside an Indian reservation, provided that the purpose of such property is to connect with qualified infrastructure property located within the reservation (*e.g.*, roads, power lines, water systems, railroad spurs, and communications facilities).¹⁶

An “Indian reservation” means a reservation as defined in section 3(d) of the Indian Financing Act of 1974 (25 U.S.C. 1452(d))¹⁷ or section 4(10) of the Indian Child Welfare Act of 1978 (25 U.S.C. 1903(10)).¹⁸ For purposes of the preceding sentence, section 3(d) is applied by treating “former Indian reservations in Oklahoma” as including only lands that are (1) within the jurisdictional area of an Oklahoma Indian tribe as determined by the Secretary of the Interior,

¹³ Section 168(j)(2) does not provide shorter recovery periods for water utility property, residential rental property, or railroad grading and tunnel bores.

¹⁴ For these purposes, the term “related persons” is defined in section 465(b)(3)(C).

¹⁵ Sec. 168(j)(4)(A).

¹⁶ Sec. 168(j)(4)(C).

¹⁷ Pub. L. No. 93-262.

¹⁸ Pub. L. No. 95-608.

and (2) recognized by such Secretary as an area eligible for trust land status under 25 C.F.R. Part 151 (as in effect on August 5, 1997).¹⁹

The depreciation deduction allowed for regular tax purposes is also allowed for purposes of the alternative minimum tax.²⁰ The accelerated depreciation for qualified Indian reservation property is available with respect to property placed in service on or before December 31, 2016.²¹ A taxpayer may annually make an irrevocable election out of section 168(j) on a class-by-class basis for qualified Indian reservation property placed in service in taxable years beginning after December 31, 2015.

Limitation on depreciation of personal use passenger automobiles

Section 280F(a) limits the annual cost recovery deduction with respect to certain passenger automobiles. This limitation is commonly referred to as the “luxury automobile depreciation limitation.” For passenger automobiles placed in service in 2016, and for which the additional first-year depreciation deduction under section 168(k) is not claimed, the maximum amount of allowable depreciation is \$3,160 for the year in which the vehicle is placed in service, \$5,100 for the second year, \$3,050 for the third year, and \$1,875 for the fourth and later years in the recovery period.²² This limitation is indexed for inflation and applies to the aggregate deduction provided under present law for depreciation and section 179 expensing.

Basis not recovered in the recovery period of a passenger automobile is allowable as an expense in subsequent taxable years.²³ The expensed amount is limited in each such subsequent taxable year to the amount of the limitation in the fourth year in the recovery period.

The special limitation for passenger automobiles is applied before the special depreciation rules for listed property and before any other reduction in the amount of the deduction allowable under section 168.

Listed property

In the case of certain listed property, special rules apply. Listed property generally is defined as (1) any passenger automobile; (2) any other property used as a means of transportation;²⁴ (3) any property of a type generally used for purposes of entertainment,

¹⁹ Sec. 168(j)(6).

²⁰ Sec. 168(j)(3).

²¹ Sec. 168(j)(8).

²² Rev. Proc. 2016-23, Table 3, 2016-16 I.R.B. 581.

²³ Sec. 280F(a)(1)(B).

²⁴ Property substantially all of the use of which is in a trade or business of providing transportation to unrelated persons for hire is not considered other property used as a means of transportation. Sec. 280F(d)(4)(C).

recreation, or amusement; (4) any computer or peripheral equipment;²⁵ and (5) any other property of a type specified in Treasury regulations.²⁶

First, if for the taxable year in which the property is placed in service, the use of the property for trade or business purposes does not exceed 50 percent of the total use of the property, then the depreciation deduction with respect to such property is determined under the alternative depreciation system.²⁷ The alternative depreciation system generally requires the use of the straight-line method and a recovery period equal to the class life of the property.²⁸ Second, if an individual owns or leases listed property that is used by the individual in connection with the performance of services as an employee, no depreciation deduction, expensing allowance, or deduction for lease payments is available with respect to such use unless the use of the property is for the convenience of the employer and required as a condition of employment.²⁹ Both limitations apply for purposes of section 179 expensing.

For listed property, no deduction is allowed unless the taxpayer adequately substantiates the expense and business usage of the property.³⁰ A taxpayer must substantiate the elements of each expenditure or use of listed property, including (1) the amount (*e.g.*, cost) of each separate expenditure and the amount of business or investment use, based on the appropriate measure (*e.g.*, mileage for automobiles), and the total use of the property for the taxable period, (2) the date of the expenditure or use, and (3) the business purposes for the expenditure or use.³¹ The level of substantiation for business or investment use of listed property varies depending on the facts and circumstances. In general, the substantiation must contain sufficient information as to each element of every business or investment use.³²

Normalization

For certain public utility property to be eligible for the more favorable depreciation allowances available under present law (relative to the depreciation allowances used for

²⁵ Computer or peripheral equipment used exclusively at a regular business establishment and owned or leased by the person operating such establishment, however, is not listed property. Sec. 280F(d)(4)(B).

²⁶ Sec. 280F(d)(4)(A).

²⁷ Sec. 280F(b)(1). If for any taxable year after the year in which the property is placed in service the use of the property for trade or business purposes decreases to 50 percent or less of the total use of the property, then the amount of depreciation allowed in prior years in excess of the amount of depreciation that would have been allowed for such prior years under the alternative depreciation system is recaptured (*i.e.*, included in gross income) for such taxable year.

²⁸ Sec. 168(g).

²⁹ Sec. 280F(d)(3).

³⁰ Sec. 274(d)(4).

³¹ Temp. Reg. sec. 1.274-5T(b)(6).

³² Temp. Reg. sec. 1.274-5T(c)(2)(ii)(C).

ratemaking or financial statement purposes), the tax benefits of accelerated depreciation must be “normalized” in setting rates charged by utilities to customers and in reflecting operating results in regulated books of account.³³

The tax benefits of accelerated depreciation are considered to be normalized only if three requirements are satisfied.³⁴ First, the tax expense of the public utility for ratemaking purposes must be computed using the same depreciation method that is used in determining depreciation for ratemaking purposes and by using a useful life that is no shorter than the useful life used in determining depreciation for ratemaking purposes (which generally results in depreciation being determined over a relatively long useful life and using the straight line method). Second, the difference between the actual tax expense computed using tax depreciation and the tax expense determined for ratemaking purposes must be reflected in a deferred tax reserve. Third, in determining the rate of return of a public utility, the public utility commission may not exclude from the rate base an amount that exceeds the addition to the deferred tax reserve for the period used in determining the tax expense for ratemaking purposes. In addition, any ratemaking procedure or adjustment with respect to a utility’s tax expense, depreciation expense, or reserve for deferred taxes must also be consistently used with respect to the other two items and rate base.³⁵

Any violation of these requirements results in the loss of the application of accelerated tax depreciation for the applicable public utility property and the depreciation allowances for such property must be determined for Federal income tax purposes under the method used for regulatory purposes.³⁶ Public utility property is defined as property used predominantly in the trade or business of the furnishing or sale of: (1) electrical energy, water, or sewage disposal services; (2) gas or steam through a local distribution system; (3) telephone services; (4) other communications services if furnished or sold by the Communications Satellite Corporation for purposes authorized by the Communications Satellite Act of 1962 (47 U.S.C. 701); or (5) transportation of gas or steam by pipeline, if the rates for such furnishing or sale are established or approved by a State or political subdivision thereof, by any agency or instrumentality of the United States, or by a public service or public utility commission or other similar body of a State or political subdivision thereof.³⁷

³³ Similar rules are provided for certain public utility property placed in service prior to 1986 (the first year that MACRS was applicable).

³⁴ Sec. 168(i)(9)(A).

³⁵ Sec. 168(i)(9)(B).

³⁶ Sec. 168(f)(2) and (i)(9)(C).

³⁷ Sec. 168(i)(10).

B. Earnings and Profits

Earnings and profits are the measure of corporate economic income that, if distributed to shareholders, is generally taxed to them as a dividend (rather than as a return of their corporate stock basis or as capital gain in excess of basis).³⁸ Although earnings and profits generally are the same as taxable income in a current year, this is not always the case. Special rules for certain types of corporate deductions and income require earnings and profits to be reduced or increased over a different period than the period in which the corporation recognizes the deductions or income for purposes of computing its income tax.³⁹ Under section 312(k), a corporation is generally required to compute its earnings and profits using the straight-line method of depreciation. In the case of tangible property to which section 168 applies, the adjustment to earnings and profits is generally determined under ADS. These rules do not apply to foreign corporations if less than 20 percent of gross income for the taxable year is derived from sources within the United States.

C. Like-Kind Exchanges

An exchange of property, like a sale, generally is a taxable event. However, no gain or loss is recognized if property held for productive use in a trade or business or for investment is exchanged for property of a “like-kind” which is to be held for productive use in a trade or business or for investment.⁴⁰ If section 1031 applies to an exchange of properties, the basis of the property received in the exchange is equal to the basis of the property transferred, decreased by any money received by the taxpayer, and further adjusted for any gain or loss recognized on the exchange. In general, section 1031 does not apply to any exchange of stock in trade or other property held primarily for sale; stocks, bonds or notes; other securities or evidences of indebtedness or interest; interests in a partnership; certificates of trust or beneficial interests; or choses in action.⁴¹

D. Involuntary Conversions

Although gain or loss realized from the sale or other disposition of property must generally be recognized, section 1033 provides an exception to this rule in the case of certain involuntary conversions of property. Section 1033 applies if property is involuntarily or compulsorily converted into similar property or money. Such a conversion may occur as a result

³⁸ Corporate distributions to shareholders are generally treated as a dividend to the extent of current or accumulated earnings and profits. Distributions in excess of that amount first reduce a shareholder’s stock basis and thereafter are treated as capital gain with respect to the stock. Sec. 301.

³⁹ See, *e.g.*, sec. 312(k) and (n).

⁴⁰ Sec. 1031(a)(1).

⁴¹ Sec. 1031(a)(2).

of the property's destruction (in whole or in part), theft, seizure, requisition or condemnation, or a sale made under the threat of requisition or condemnation.⁴²

For purposes of section 1033, condemnation refers to the process by which private property is taken for public use without the consent of the property owner but upon the award and payment of just compensation.⁴³ Thus, for example, an order by a Federal court to a corporation to divest itself of ownership of certain stock because of anti-trust rules is not a condemnation (or a threat of imminence thereof), and the divestiture is not eligible for deferral under this provision.⁴⁴

If property is involuntarily converted into property that is similar or related in service or use to the property so converted, no gain is recognized. This treatment is not elective. The replacement property may be acquired directly or by acquiring control of a corporation (generally, 80 percent of the stock of the corporation) that owns replacement property. If the taxpayer receives money (for instance, insurance payments or condemnation awards) or other dissimilar property for the involuntarily converted property, and acquires qualified replacement property within the prescribed time period, nonrecognition of the gain is optional.⁴⁵ As a general matter, the prescribed time period begins on the date of the disposition of the converted property (or threat or imminence of a threat of condemnation begins) and ends two years after the close of the first taxable year in which any part of the gain upon the conversion is realized.⁴⁶

The taxpayer's basis in the replacement property is the same as the taxpayer's basis in the converted property, decreased by the amount of any money received or loss recognized on the conversion, and increased by the amount of any gain recognized on the conversion.⁴⁷

E. Treatment of Gains from Depreciable Property

In general

Upon disposition of most property used in a business with respect to which depreciation or amortization deductions were taken, the treatment of the resulting gain or loss as ordinary or capital depends on whether there is a net gain or a net loss under section 1231. If the netting of gains and losses results in a net gain, then, subject to the depreciation recapture rules, long-term

⁴² Sec. 1033(a).

⁴³ Rev. Rul. 58-11, 1958-1 C.B. 273.

⁴⁴ *Ibid.* If the replacement property is stock of a corporation and if the stock basis is decreased under this rule, the aggregate basis of the corporation's assets is likewise decreased by the same amount (but not below that stock basis as so decreased). Sec. 1033(b)(3).

⁴⁵ Sec. 1033(a)(2)(A).

⁴⁶ Sec. 1033(a)(2)(B).

⁴⁷ Sec. 1033(b).

capital gain treatment results.⁴⁸ If the netting of gains and losses results in a loss, the loss is fully deductible against ordinary income.⁴⁹

The depreciation recapture rules require taxpayers to recognize ordinary income in an amount equal to all or a portion of the gain realized as a result of the disposition of property. The purpose of the rules is to limit a taxpayer's ability to reduce ordinary income via depreciation deductions and then receive capital gain treatment for the portion of any gain on the disposition of the depreciated property that resulted from the taking of depreciation deductions. There are two regimes that dictate depreciation recapture, sections 1245 and 1250.⁵⁰

Section 1245 property

Depreciable personal property, whether tangible or intangible, and certain depreciable real property (typically real property that performs specific functions in a business, but not buildings or structural components of buildings) disposed of at a gain are known as section 1245 property.⁵¹ When a taxpayer disposes of section 1245 property, the taxpayer must recapture the gain on disposition of the property as ordinary income to the extent of earlier depreciation or amortization deductions taken with respect to the asset.⁵² Any remaining gain recognized upon the sale of section 1245 property is treated as section 1231 gain.

Section 1250 property

Depreciable real property, other than that included within the definition of section 1245 property, disposed of at a gain is known as section 1250 property.⁵³ Gain on the disposition of section 1250 property is treated as ordinary income, rather than capital gain, only to the extent of the excess of post-1969 depreciation allowances over the depreciation that would have been available under the straight-line method.⁵⁴ However, if section 1250 property is held for one year or less, all depreciation is recaptured, regardless of whether it exceeds the depreciation that

⁴⁸ Sec. 1231(a)(1).

⁴⁹ Sec. 1231(a)(2).

⁵⁰ Cost recovery deductions taken under the Accelerated Cost Recovery System ("ACRS") (for property placed in service after 1980 and before 1987 (before August 31, 1986, if the taxpayer so elected)) generally are subject to recapture; however, properties are not necessarily classified as section 1245 or 1250 property in the same manner as similar properties placed in service before or after ACRS.

⁵¹ Sec. 1245(a)(3).

⁵² Sec. 1245(a)(1).

⁵³ Sec. 1250(c).

⁵⁴ Sec. 1250(a)(1).

would have been available under the straight-line method. Special rules phase out the recapture for certain types of property held over a specified period of time.⁵⁵

For corporations, the amount treated as ordinary income on the disposition of section 1250 property is increased by 20 percent of the additional amount that would be treated as ordinary income if the property were subject to recapture under the rules for section 1245 property.⁵⁶ For individuals, any capital gain that would be treated as ordinary income if the property were subject to recapture under the rules for section 1245 property is taxed at a maximum rate of 25 percent.

Additional recapture rules

Recapture rules apply under other cost recovery provisions, including sections 179 and 197. For recapture purposes, an amortizable section 197 intangible is considered section 1245 property and is subject to section 1245 recapture rules.⁵⁷

Recapture rules also apply to certain business credits. For example, if property eligible for an investment tax credit is disposed of, or otherwise ceases to be investment tax credit property (*e.g.*, casualty loss), before the close of the recapture period (five years), the tax for the year is increased by a recapture percentage.⁵⁸ Advance rehabilitation and certain energy credits and credits related to certain energy property also are subject to recapture provisions. In addition, in determining the amount of gain that is recaptured as ordinary income under section 1245 or section 1250, the amount of an investment credit downward basis adjustment also is treated as a deduction allowed for depreciation.⁵⁹

⁵⁵ Sec. 1250(a)(1)(B). The special phase-out rule applies to residential rental property, certain types of subsidized housing, and property for which rapid depreciation of rehabilitation expenditures was claimed under section 167(k).

⁵⁶ Sec. 291(a)(1).

⁵⁷ Sec. 197(f)(7).

⁵⁸ Sec. 50(a).

⁵⁹ Sec. 50(c)(4).

II. DESCRIPTION OF PROPOSAL

A. In General

The proposal repeals present law depreciation rules under section 168(a) – (j) and replaces those rules with a pooling cost recovery system for “pooled property” (*e.g.*, most tangible property and computer software) and a straight line cost recovery system for “straight line property” (*i.e.*, real property, water utility property, and railroad grading or tunnel bore) (collectively, “section 168 property”). The term “section 168 property” does not include motion picture films, video tapes, sound recordings,⁶⁰ or public utility property if the taxpayer does not use a normalization method of accounting.

B. Pooled Property

In general

In the case of pooled property, costs are recovered by multiplying the applicable recovery rate for each pool by the associated pool balance at year-end. “Pooled property” is defined as any tangible property which is not straight line property, and any computer software (as defined in section 197(e)(3)(B)) that is not an amortizable section 197 intangible, assigned to any one of the six pools (detailed in Table 3 below). The classification and assignment of pooled property in Table 3 below is based on section 168(e)(3), as in effect on the day before the date of enactment of the discussion draft, and Revenue Procedure 87-56 (or any amendment thereto made before the date of enactment of the discussion draft).

Table 3.—Pooled Property by Pool

Property	Classification ⁶¹
POOL 1	
Tractor units for use over-the-road	00.26
Any breeding or work horse that is more than 12 years old at the time it is placed in service	Section 168(c)(2)(A)(iii) ⁶² and 01.222

⁶⁰ “Sound recordings” are any works resulting from the fixation of a series of musical, spoken, or other sounds, regardless of the nature of the material (*e.g.*, discs, tapes, or other phonorecordings) in which such sounds are embodied.

⁶¹ Except where noted, the classification is based on the asset class categorization provided in Rev. Proc. 87-56, 1987-2 C.B. 674. Any reference to Rev. Proc. 87-56 includes any amendment to Rev. Proc. 87-56 (*e.g.*, Rev. Proc. 88-22, 1988-1 C.B. 785). The assignment of asset classes based on the categorization provided in Rev. Proc. 87-56 is not intended to disrupt IRS guidance (*e.g.*, Rev. Proc. 2011-22, 2011 I.R.B. 737).

⁶² The section number refers to 3-year property described in such section of the discussion draft.

Property	Classification⁶¹
Any race horse (i) placed in service before January 1, 2017, or (ii) placed in service after December 31, 2016, that is more than two years old at the time it is placed in service	Section 168(c)(2)(A)(ii) ⁶³ and 01.223
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	01.224
Hogs, breeding	01.23
Manufacture of food and beverages—Special handling devices	20.5
Manufacture of rubber products—Special tools and devices	30.11
Manufacture of finished plastic products—Special tools	30.21
Manufacture of glass products—Special tools	32.11
Manufacture of fabricated metal products – Special tools	34.01
Manufacture of motor vehicles—Special tools	37.12
Qualified rent to own property	Section 168(i)(14) ⁶⁴
Computer software	Section 168(b)(2)(B) ⁶⁵
POOL 2	
Information systems	00.12
Data handling equipment, except computers	00.13

⁶³ The section number refers to race horses described in such section of the discussion draft.

⁶⁴ The section number refers to an asset defined in such section as in effect on the day before the date of enactment of the discussion draft.

⁶⁵ The section number refers to computer software described in such section of the discussion draft.

Property	Classification⁶¹
Airplanes (airframes and engines), except those used in commercial or contract carrying of passengers or freight, and all helicopters	00.21
Automobiles, taxis	Section 168(c)(2)(B)(ii) ⁶⁶ and 00.22
Buses	00.23
Light general purpose trucks	Section 168(c)(2)(B)(ii) ⁶⁷ and 00.241
Heavy general purpose trucks	00.242
Trailers and trailer-mounted containers	00.27
Cattle, breeding or dairy	01.21
Sheep and goats, breeding	01.24
Offshore drilling	13.0
Drilling of oil and gas wells	13.1
Construction	15.0
Manufacture of knitted goods	22.1
Manufacture of carpets and dyeing, finishing, and packaging of textile products and manufacture of medical and dental supplies	22.3
Manufacture of textured yarns	22.4
Manufacture of apparel and other finished products	23.0
Cutting of timber	24.1
Sawing of dimensional stock from logs	24.3
Manufacture of chemicals and allied products	28.0

⁶⁶ The section number refers to 5-year property described in such section of the discussion draft.

⁶⁷ The section number refers to 5-year property described in such section of the discussion draft.

Property	Classification⁶¹
Manufacture of primary nonferrous metals–Special tools	33.21
Manufacture of electronic components, products and systems	36.0
Any semiconductor manufacturing equipment	Section 168(c)(2)(B)(ii) ⁶⁸ and 36.1
Ship and boat building –Special tools	37.33
Motor transport–Passengers	41.0
Motor transport–Freight	42.0
Air transport (restricted)	45.1
Computer-based telephone central office switching equipment	Section 168(c)(2)(B)(ii) ⁶⁹ and 48.121
Radio and television broadcastings	48.2
TOCSC ⁷⁰ –Satellite space segment property	48.37
CATV ⁷¹ –Program origination	48.43
CATV–Service and test	48.44
CATV–Microwave systems	48.45
Electric utility nuclear fuel assemblies	49.121
Distributive trades and services	57.0
Qualified technological equipment	Section 168(i)(2) ⁷²

⁶⁸ The section number refers to 5-year property described in such section of the discussion draft.

⁶⁹ The section number refers to 5-year property described in such section of the discussion draft.

⁷⁰ “TOCSC” stands for telegraph, ocean cable, and satellite communications.

⁷¹ “CATV” stands for cable television.

⁷² The section number refers to an asset defined in such section as in effect on the day before the date of enactment of the discussion draft.

Property	Classification⁶¹
Any section 1245 property used in connection with research and experimentation	Section 168(i)(11) ⁷³
Certain energy property	Sections 168(e)(3)(B)(vi) ⁷⁴ and 48(a)(3)(A)
POOL 3	
Office furniture, fixtures and equipment	00.11
Railroad cars and locomotives, except those owned by railroad transportation companies	00.25
Agriculture	01.1
Cotton ginning assets	01.11
Any breeding or work horse that is 12 years old or less at the time it is placed in service	01.221
Any horse not described in classes 01.221, 01.222, 01.223, or 01.224	01.225
Mining	10.0
Exploration for and production of petroleum and natural gas deposits	13.2
Manufacture of other food and kindred products	20.4
Manufacture of tobacco and tobacco products	21.0
Manufacture of yarn, thread, and woven fabric	22.2
Manufacture of nonwoven fabrics	22.5
Sawing of dimensional stock from logs	24.2
Manufacture of wood products and furniture	24.4
Manufacture of pulp and paper	26.1

⁷³ The section number refers to an asset defined in such section as in effect on the day before the date of enactment of the discussion draft.

⁷⁴ The section number refers to an asset defined in such section as in effect on the day before the date of enactment of the discussion draft.

Property	Classification⁶¹
Manufacture of converted paper, paperboard, and pulp products	26.2
Printing, publishing, and allied industries	27.0
Manufacture of rubber products	30.1
Manufacture of finished plastic products	30.2
Manufacture of leather and leather products	31.0
Manufacture of glass products	32.1
Manufacture of other stone and clay products	32.3
Manufacture of primary nonferrous metals	33.2
Manufacture of foundry products	33.3
Manufacture of primary steel mill products	33.4
Manufacture of fabricated metal products	34.0
Manufacture of electrical and non-electrical machinery and other mechanical products	35.0
Manufacture of motor vehicles	37.11
Manufacture of aerospace products	37.2
Ship and boat building machinery and equipment	37.31
Manufacture of locomotives	37.41
Manufacture of railroad cars	37.42
Manufacture of athletic, jewelry and other goods	39.0
Railroad machinery and equipment	40.1
Railroad track	40.4
Air transport	45.0

Property	Classification⁶¹
Telephone station equipment (other than qualified technological equipment as defined in section 168(i)(2) ⁷⁵)	48.13
TOCSC—High frequency radio and microwave system	48.32
TOCSC—Computerized switching, channeling, and associated control equipment	48.35
TOCSC—Satellite ground segment property	48.36
TOCSC—Equipment installed on customer’s premises	48.38
TOCSC—Support and service equipment	48.39
CATV—Headend	48.41
CATV—Subscriber connection and distribution systems	48.42
Gas utility substitute natural gas (SNG) production plant (naphtha or lighter hydrocarbon feedstocks)	49.222
Natural gas production plant	49.23
Waste reduction and resource recovery plants	49.5
Recreation	79.0
Theme and amusement parks	80.0
Personal property and real property that is section 1245 property ⁷⁶ not assigned a class life	Section 168(e)(3)(C)(v) ⁷⁷

⁷⁵ The section number refers to an asset defined in such section as in effect on the day before the date of enactment of the discussion draft.

⁷⁶ “Section 1245 property” refers to an asset defined under such section as in effect for taxable years beginning in 2016.

⁷⁷ The section number refers to an asset defined in such section as in effect on the day before the date of enactment of the discussion draft.

Property	Classification ⁶¹
POOL 4	
Vessels, barges, tugs, and similar water transportation equipment, except those used in marine construction	00.28
Single purpose agricultural or horticultural structures (within the meaning of section 168(i)(13) ⁷⁸)	Section 168(c)(2)(D)(ii) ⁷⁹ and 01.4
Petroleum refining	13.3
Manufacture of grain and grain mill products	20.1
Manufacture of sugar and sugar products	20.2
Manufacture of vegetable oils and vegetable oil products	20.3
Ship and boat building dry docks and land improvements	37.32
Telephone central office equipment	48.12
TOCSC—Electric power generating and distribution systems	48.31
TOCSC—Central office control equipment	48.34
Substitute natural gas-coal gasification	49.223
Solar and wind energy	Section 168(e)(3)(B)(vi) ⁸⁰
Tree or vine bearing fruit or nuts	Section 168(e)(3)(D)(ii) ⁸¹

⁷⁸ The section number refers to an asset defined in such section as in effect on the day before the date of enactment of the discussion draft.

⁷⁹ The section number refers to 10-year property described in such section of the discussion draft.

⁸⁰ The section number refers to an asset described in such section as in effect for taxable years beginning in 2014.

⁸¹ The section number refers to an asset defined in such section as in effect on the day before the date of enactment of the discussion draft.

Property	Classification ⁶¹
POOL 5	
Land improvements	00.3
Industrial steam and electric generation and/or distribution systems	00.4
Manufacture of cement	32.2
Railroad wharves and docks	40.3
Railroad nuclear electric generating equipment	40.52
Water transportation	44.0
Pipeline transportation	46.0
Telephone distribution plant	48.14
Electric utility nuclear production plant	49.12
Electric utility combustion turbine production plant	49.15
Gas utility trunk pipelines and related storage facilities	49.24
Liquefied natural gas plant	49.25
Municipal wastewater treatment plant	50.0
Distributive trades and services—Billboard, service station buildings and petroleum marketing land improvements	57.1
POOL 6	
Farm buildings except structures included in class 01.4	01.3
Railroad structures and similar improvements	40.2
Railroad hydraulic electric generating equipment	40.51
Railroad steam electric generating equipment	40.53
Railroad steam, compressed air, and other power plant equipment	40.54

Property	Classification⁶¹
Telephone central office buildings	48.11
TOCSC–Cable and long-line systems	48.33
Electric utility hydraulic production plant	49.11
Electric utility steam production plant	49.13
Electric utility transmission and distribution plant	49.14
Gas utility distribution facilities	49.21
Gas utility manufactured gas production plants	49.221
Central steam utility production and distribution	49.4
Municipal sewer	51.0

Applicable rates

The applicable recovery rates for the six pools are:

- Pool 1: 49 percent;
- Pool 2: 34 percent;
- Pool 3: 25 percent;
- Pool 4: 18 percent;
- Pool 5: 11 percent; and
- Pool 6: eight percent.

Foreign assets

In instances where assets used predominantly outside the United States (“foreign assets”) and assets used predominantly inside the United States (“domestic assets”) are owned by (and used in) the same trade or business, the foreign assets must be pooled separately from the domestic assets in order to permit necessary foreign sourcing calculations and any other necessary allocations with respect to foreign assets. Thus, a trade or business with both foreign assets and domestic assets may have two of each pool.

Pool balances

In general

To determine an asset pool balance as of the close of the taxable year, a taxpayer generally must take in to account additions to and subtractions from the pool, as well as any depreciation deduction or negative pool balance adjustment (discussed below).

First taxable year.—For the first taxable year beginning after December 31, 2016, each asset pool balance is determined by:

(1) adding the adjusted basis of (A) any pooled property held by the taxpayer on the first day of such taxable year assigned to such asset pool;⁸² (B) any pooled property placed in service by the taxpayer during the taxable year assigned to such asset pool; and (C) to the extent not already included by reason of (B), any capitalizable addition or improvement made to pooled property placed in service by the taxpayer during the taxable year assigned to such asset pool; and

(2) subtracting (A) the amount of any reduction pursuant to a discharge of indebtedness;⁸³ (B) except as provided in (C), the gross proceeds from the disposition or transfer during the taxable year of any asset assigned to such pool; and (C) in the case of any pooled property disposed of or transferred to a related person or tax shelter or any other pooled property which the taxpayer continues to use after its disposition, the recomputed basis (discussed below).

Subsequent taxable years.—For each subsequent taxable year, a taxpayer must first compute each asset pool's adjusted balance. The adjusted balance of an asset pool is the prior year's ending pool balance decreased by the amount of any prior year depreciation deduction claimed with respect to such pool and increased by the amount of any prior year gain recognized with respect to a negative pool balance for such pool. To determine the pool balance as of the close of the taxable year, a taxpayer begins with the adjusted balance then:

(1) adds the adjusted basis of: (A) any pooled property placed in service by the taxpayer during the taxable year assigned to such asset pool; and (B) to the extent not already included by reason of (A), any capitalizable addition or improvement made to pooled property placed in service by the taxpayer during the taxable year assigned to such asset pool; and

(2) subtracts: (A) the amount of any reduction pursuant to a discharge of indebtedness; (B) except as provided in (C), the gross proceeds from the disposition or transfer during the taxable year of any asset assigned to such pool; and (C) in the case of any pooled property

⁸² The term “any pooled property held by the taxpayer” includes pooled property with zero adjusted basis.

⁸³ For this purpose, the relevant subsections are (b)(2)(E), (b)(5), and (c)(1) of section 108, as amended by the discussion draft.

disposed of or transferred to a related person or tax shelter or any other pooled property which the taxpayer continues to use after its disposition, the recomputed basis (discussed below).

Pooling example

Suppose a calendar year taxpayer offers music lessons at a studio. The taxpayer owns the following assets on January 1, 2017, each with an adjusted basis as indicated: (1) \$1,000 computer software (section 168(b)(2)(B)⁸⁴); (2) \$1,000 light truck (asset class 0.241 under Rev. Proc. 87-56) used 100 percent for business use; (3) \$1,000 violin (personal property not assigned a class life under Rev. Proc. 87-56); and (4) \$1,000 sidewalks and other land improvements around the studio (asset class 00.3 under Rev. Proc. 87-56). As of January 1, 2017, the taxpayer has a pool balance of \$1,000 in each of pools 1, 2, 3 and 5.

On February 1, 2017, the taxpayer acquires new computer software for \$2,000. On March 1, 2017, the taxpayer sells the violin to an unrelated party for \$1,500. On March 2, 2017, the taxpayer acquires a viola for \$1,700. On April 1, 2017, the taxpayer sells the light truck for \$500 and acquires a new light truck for \$1,500. The taxpayer makes no improvements to the land around the studio or to the building in 2017. The following describes the depreciation deductions allowable to the taxpayer.

Pool 1: The beginning balance of pool 1 is \$1,000. The taxpayer acquired new computer software for \$2,000 and added it to the pool for a balance of \$3,000. The applicable rate of depreciation for assets in pool 1 is 49 percent. For 2017, the taxpayer is allowed a deduction for depreciation with respect to pool 1 of \$1,470 (0.49 multiplied by \$3,000). The \$1,470 of depreciation for 2017 is deducted from the balance of pool 1, resulting in an adjusted balance of \$1,530 for 2018.

Pool 2: The beginning balance of pool 2 is \$1,000. During 2017, the taxpayer sold the light truck for \$500 and acquired another for \$1,500, to be used 100 percent for business use. The balance of pool 2 is reduced by the proceeds of the sale of the old truck and is increased by the basis of the new truck. The pool balance before depreciation is \$2,000 (\$1,000 - \$500 + \$1,500). The applicable rate of depreciation for assets in pool 2 is 34 percent. For 2017, the taxpayer is allowed a deduction for depreciation with respect to pool 2 of \$680 (0.34 multiplied by \$2,000). The taxpayer recognizes no loss on the sale of the old truck. However, the taxpayer is permitted to continue to recover the remaining basis in the old truck, thus recognizing the loss over time. The \$680 of depreciation is deducted from the balance of pool 2, resulting in an adjusted balance of \$1,320 for 2018.

Pool 3: The beginning balance of pool 3 is \$1,000. In 2017, the taxpayer sold a violin to an unrelated party for \$1,500 and acquired a viola for \$1,700. The balance of pool 3 is reduced by the proceeds of the sale of the violin but is increased by the basis of the viola. The pool balance before depreciation is \$1,200 (\$1,000 - \$1,500 + \$1,700). The applicable rate of depreciation for assets in pool 3 is 25 percent. For 2017, the taxpayer is allowed a deduction for depreciation with respect to pool 3 of \$300 (0.25 multiplied by \$1,200). The taxpayer recognizes no gain on the sale of the violin. However, the taxpayer is only permitted to depreciate \$1,200 of

⁸⁴ The section number refers to computer software described in such section of the discussion draft.

the cost of the viola, rather than \$1,700. The \$300 of depreciation for 2017 is deducted from the balance of pool 3, resulting in an adjusted balance of \$900 for 2018.

Pool 5: The beginning balance of pool 5 is \$1,000. The taxpayer has no additions to the pool for 2017. The applicable rate of depreciation for assets in pool 5 is 11 percent. For 2017, the taxpayer is allowed a deduction for depreciation with respect to pool 5 of \$110 (0.11 multiplied by \$1,000). The \$110 of depreciation for 2017 is deducted from the balance of pool 5, resulting in an adjusted balance of \$890 for 2018.

The taxpayer is allowed a total deduction for depreciation in 2017 with respect to his trade or business of \$2,560 (\$1,470 + \$680 + \$300 + \$110).

Special rules

The increase in balance in any asset pool with respect to any passenger automobile may not exceed \$45,000. A “passenger automobile” is defined as any four-wheeled vehicle which is (1) manufactured primarily for use on public streets, roads, and highways, and (2) rated at 6,000 pounds unloaded gross vehicle weight or less.⁸⁵ Excluded from the definition of a passenger automobile is (1) any ambulance, hearse, or combination ambulance-hearse used by the taxpayer directly in a trade or business, (2) any vehicle used by the taxpayer directly in the trade or business of transporting persons or property for compensation or hire, and (3) under regulations, any truck or van. As noted above, passenger automobiles are assigned to pool 2.

In general, pool balances that are less than zero at year-end (“negative pool balances”) give rise to section 1245 gain. The amount of section 1245 gain recognized is added to the pool balance to restore such pool balance to zero. For example, suppose that the taxpayer in the example above had not purchased a viola in 2017. The proceeds from the sale of the violin are still subtracted from the balance of pool 3, resulting in a balance before depreciation of -\$500 (\$1,000 - \$1,500). The \$500 negative balance is treated as gain from the disposition of section 168 property for purposes of section 1245. Thus, the taxpayer recognizes \$500 of gain as ordinary income. The balance of pool 3 is increased by the amount of gain recognized, restoring the taxpayer’s pool balance to zero for the subsequent year’s calculation.

Similarly, if there are no assets remaining in a pool at year-end, any positive year-end balance in the pool may be deducted as a terminal loss with respect to that pool. Additionally, a taxpayer may deduct any pool balance at year-end of \$1,000 or less (“*de minimis* balance”). Any amount deducted as a terminal loss or *de minimis* balance with respect to a pool is an ordinary loss and is subtracted from the pool balance to restore the taxpayer’s pool balance to zero for the subsequent year’s calculation.

Leasebacks and dispositions to related parties and tax shelters

In the case of pooled property disposed of or transferred to a related person or to a tax shelter, the pool balance is reduced by the lesser of the recomputed basis or the gross proceeds from the sale. The recomputed basis of any pooled property is determined by calculating the

⁸⁵ In the case of a truck or van, “unloaded gross vehicle weight” is replaced with “gross vehicle weight”.

pool balance as if such property (including any additions or improvements to such property) had been the only property assigned to such pool since acquisition. A “related person” is related to any other person if the related person bears a relationship to such other person described in section 267(b) or 707(b)(1) or the related person and such other person are engaged in a trade or business under common control (within the meaning of section 41(f)(1)(A) and (B)).⁸⁶ A tax shelter has the meaning given such term in section 461(i)(3).

If a taxpayer continues to use pooled property after its disposition (*e.g.*, sale-lease-back transaction), the pool balance is reduced by the lesser of the recomputed basis (as defined above) or gross proceeds from the sale.

The excess of the fair market value of the property disposed of or transferred over the recomputed basis is treated as section 1245 gain. The purchaser (or transferee) adds the asset to the appropriate pool at its purchase price.

Earnings and profits

In the case of pooled property, the adjustment to earnings and profits for depreciation for taxable years beginning after December 31, 2016, is determined using the pooled asset cost recovery system.

C. Straight Line Property

In the case of straight line property, costs are recovered ratably (without regard to salvage value) over the applicable recovery period, beginning with the midpoint of the month in which the asset is placed in service. Table 4 includes all assets classified as “straight line property.”

Table 4.—Straight Line Property

Property	Classification⁸⁷	Recovery Period
Water utility property	Section 168(i)(8) ⁸⁸ and 49.3	25 years
Residential rental property	Section 168(i)(4) ⁸⁹	27.5 years

⁸⁶ A person is treated as related to another person if such relationship exists immediately before or immediately after the acquisition of the property involved.

⁸⁷ Except where noted, the classification is based on the asset class categorization provided in Rev. Proc. 87-56, 1987-2 C.B. 674. Any reference to Rev. Proc. 87-56 includes any amendment to Rev. Proc. 87-56 (*e.g.*, Rev. Proc. 88-22, 1988-1 C.B. 785).

⁸⁸ The section number refers to water utility property described in such section of the discussion draft.

⁸⁹ The section number refers to residential rental property described in such section of the discussion draft.

Property	Classification ⁸⁷	Recovery Period
Nonresidential real property	Section 168(i)(5) ⁹⁰	39 years
Railroad grading or tunnel bore	Section 168(i)(7) ⁹¹	50 years

Assignments, classifications, and modifications

The proposal grants the Secretary⁹² authority to issue guidance to: (1) reclassify assets (or categories of assets) as straight line property or as pooled property; (2) modify the class life given to pooled property under Revenue Procedure 87-56; and (3) modify asset classes described in Revenue Procedure 87-56 or create new categories of assets. Any reclassifications or modifications must be made based on the anticipated useful life and the anticipated decline in value over time of the asset, and after taking into account when the asset is technologically or functionally obsolete. With respect to pooled property, any reclassifications or modifications will be within the six pools. Further, in any case where the Secretary makes a reclassification or modification, the Secretary must publish a schedule reflecting all classifications and assignments (including the modification(s) to such classifications and assignments) for all section 168 property. Such publication is treated as a major rule for purposes of applying chapter 8 of title 5 of the United States Code, the Congressional review of agency rulemaking.

Additionally, within five years of the date of enactment of the discussion draft, and at least every 10 years thereafter, the Secretary in consultation with the Secretary of Commerce (*i.e.*, the Bureau of Economic Analysis),⁹³ must submit a report to Congress analyzing the classification and assignment of all section 168 property, including the classification of assets as pooled property or straight line property, assignments of assets to pools, the number of asset pools, the applicable rates for such pools, and the recovery periods for straight line property.

D. Business Use

Business use percentage

In general, for property used in a trade or business not more than 50 percent of the time (“personal-use property”), the taxpayer is required to reduce the depreciation deduction by the

⁹⁰ The section number refers to nonresidential real property described in such section of the discussion draft.

⁹¹ The section number refers to railroad grading or tunnel bore described in such section of the discussion draft.

⁹² Unless otherwise noted, any reference to the “Secretary” means the Secretary of the Treasury.

⁹³ It is expected that the Secretary of the Treasury will consult with the Bureau of Economic Analysis within the Commerce Department, which estimates economic depreciation for purposes of the National Income and Product Accounts. The purpose of these estimates is to measure the consumption of fixed capital for purposes of accurately measuring the components of gross domestic product.

personal use percentage⁹⁴ with respect to the asset multiplied by the amount determined by applying the applicable rate for the asset pool to the excess of (A) the amount of the increase in the pool at the time the asset was placed in service, over (B) the amount of the depreciation deductions that would have been allowed for all prior taxable years since the asset was placed in service if such asset were the only asset in the pool.

Listed property

The proposal repeals the depreciation limitations under section 280F that apply to listed property, but continues the substantiation requirements under section 274 for such property, except as specified. In particular, the exception for certain computers is modified such that any computer or peripheral equipment used primarily in the taxpayer's trade or business and owned or leased by the person operating such trade or business is not listed property⁹⁵ (and therefore not subject to the heightened substantiation requirements that apply to listed property).

E. Like-Kind Exchanges

Under the proposal, a like-kind exchange (as defined in section 1031) of pooled property is considered to occur in the taxable year which includes the earliest of (i) the date that the taxpayer receives the replacement property in the exchange, (ii) the identification of the property to be received within 45 days after the date on which the taxpayer transfers the property relinquished in the exchange, or (iii) the receipt of the property not more than 180 days after the date on which the taxpayer relinquishes the original property (but in no event later than the due date (including extensions) of the taxpayer's income tax return for the taxable year in which the transfer of the relinquished property occurs).

In the case of a like-kind exchange of pooled property where the replacement property is not assigned to the same asset pool as the relinquished property, the asset pool of the relinquished property is reduced by the lesser of: (1) the fair market value of such property on the deemed date of the exchange, or (2) the positive balance of the asset pool (if any). The balance of the replacement property's assigned asset pool increases by the same amount of the reduction in the relinquished property's asset pool.

⁹⁴ The term "personal use percentage" means the percentage of the use of any property during any taxable year which is not a qualified business use. "Qualified business use" means any use in a trade or business of the taxpayer, not including (i) leasing property to any 5-percent owner or related person, (ii) use of property provided as compensation for the performance of services by a 5-percent owner or related person, or (iii) use of property provided as compensation for the performance of services by any person not described in clause (ii) unless an amount is included in the gross income of such person with respect to such use subject to the required withholding under chapter 24.

⁹⁵ For purposes of this sentence, a computer used in a dwelling unit is not treated as used primarily in a taxpayer's trade or business unless the requirements of section 280A(c)(1) are met with respect to the portion of such dwelling unit in which the computer is located.

F. Involuntary Conversions

Under the proposal, an involuntary conversion (as defined in section 1033) of pooled property is considered to occur in the taxable year which includes the earliest of (i) the date the taxpayer acquires replacement property, or (ii) the end of the second tax year after the year of the involuntary conversion (the end of the fourth tax year in the case of livestock sold on account of drought, flood, or other weather-related conditions). Special transition rules apply for involuntary conversions where qualifying replacement property has not been placed in service as of the effective date.

In the case of an involuntary conversion of pooled property where the replacement property is not assigned to the same asset pool as the relinquished property, the asset pool of relinquished property is reduced by the lesser of: (1) the fair market value of the replacement property, or (2) the positive balance of the asset pool (if any). The balance of the replacement property's assigned asset pool increases by the same amount of the reduction in the relinquished property's asset pool.

G. Gains from Disposition of Pooled Property

With respect to pooled property, the proposal requires all section 1245 gain (*e.g.*, section 1245 gain from sales to related parties or related to negative pool balances) to be treated as ordinary income.

H. Business Property on An Indian Reservation

The proposal permits a taxpayer to expense 20 percent of the cost of qualified Indian reservation property when such property is placed in service. A taxpayer may annually make an irrevocable election out of the expensing proposal on a class-by-class basis.

A special rule applicable to qualified Indian reservation property placed in service in a taxable year beginning before January 1, 2017, provides that such property is treated as placed in service on the first day of the taxpayer's first taxable year beginning after December 31, 2016, and the adjusted basis of such property is treated as the cost of such property for purposes of the expensing proposal. The amount expensed under the proposal reduces the adjusted basis of such property before it is assigned to a pool.

III. EFFECTIVE DATE

The amendments made by this proposal generally apply to taxable years beginning after December 31, 2016.

The proposal granting the Secretary authority to modify class lives is effective on the date of enactment.

The proposal relating to business property on an Indian reservation applies to property placed in service before January 1, 2017, and held by the taxpayer on the first day of the taxpayer's first taxable year beginning after December 31, 2016.