Accounting Methods Spotlight

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Guidance...

CCA Addresses Deductibility of Facility Fees

In CCA 201121001, the IRS addressed whether, for purposes of section 461, an accrual method taxpayer's liability for a facility fee is to be treated as (a) an interest liability, (b) a liability for the provision of services, or (c) a liability described in Treas. Reg. 1.461-4(g)(1)-(6) or (7).

Taxpayer used the accrual method and was organized as a limited liability partnership in the business of constructing and operating a residential housing project. In order for Taxpayer to receive a lower interest rate on a bond, Limited Partner agreed to guarantee the bond for Taxpayer. The Partnership Agreement states that in each fiscal year that the bonds are outstanding, Taxpayer must pay a Facility Fee to Limited Partner so that Limited Partner will continue to guarantee the bond. A Facility Fee is an annual fee which varies depending on the amount of the bond outstanding. Taxpayer deducted a certain amount on its Year 1 and Year 2 partnership returns, but Taxpayer has deferred payment of the Facility Fee to Limited Partner in Year 1 and Year 2.

The IRS concluded that such payments fail to qualify as interest deductible as it is accrued under section 163, or as the transfer of property in connection with the performance of services under section 83. Moreover, the IRS provided that for purposes of section 461 the payment of the facility fee is an “other liability” under Treas. Reg. 1.461-4(g)(7), and economic performance takes place when payment is made to the limited partner.

Service Station Building Qualifies as 15-Year Property

In CCA 201123001, the IRS addressed whether property used primarily as a service station is includable in Asset Class 57.1 of Rev. Proc. 87-56, with a 15-year recovery period for purposes of section 168(a), or is it nonresidential real property with a 39-year recovery period for purposes of section 168(a).

Taxpayer is a corporation with a portion of its business focused on providing full-service leasing and contract maintenance programs. Taxpayer purchased a special purpose industrial building structure, a fuel island located in the rear of the property, a large paved lot with parking spaces, and billboards. The building at issue is the special purpose industrial building, a single structure containing office space, restrooms, a work room, a mechanical room, a truck service center, and a truck wash. The office space is comprised of several executive offices, open office areas, restrooms, and a conference room. Because the building other than its front portion is more than one story, the front portion does not share a roof with the remaining portion of the building. The front portion of this building also is entirely separated from the remainder of the property building. The remaining portion of the building is a truck service center where Taxpayer provides maintenance services such as front-end alignments, oil changes, mechanical work, and other truck repair services to the trucks it leases and to other truck fleet owners.

The IRS provided that the property building is a service station building includable in Asset Class 57.1 of Rev. Proc. 87-56, with a 15-year recovery period for purposes of section 168(a), as opposed to nonresidential real property. The IRS reasoned that the truck service center portion of the property building possesses the features typically associated with a service station building such as service bays to provide maintenance services for trucks and a fuel island. Further buttressing the service station position, the IRS noted that Taxpayer sold fuel and oil, along with lube and other petroleum products as part of its maintenance and repair business, at the truck service center in the property building. Finally, the IRS noted that the vast majority (84%) of the floor space of the property building was used as the truck service center. Thus, the property is a service station building with a 15-year recovery period.

IRS Rules on Electricity Interconnection Facilities

In PLR 201122005, the IRS addressed Taxpayer's request for a ruling that a transfer of interconnection facilities ("intertie") by Generator of electricity to Taxpayer, an electric company, will not be considered a contribution in aid of construction under section 118(b) (CIAC), and will be excludable from Taxpayer's income as a non-shareholder contribution to capital under section 118(a).

Taxpayer is a corporation engaged in the business of generating, transmitting and distributing electrical energy to wholesale and retail customers predominantly. Generator will own, operate and maintain a facility to generate electricity for Taxpayer. Taxpayer and Generator agreed that Generator interconnect its facility to Taxpayer's distribution system. Taxpayer will engineer, design, procure, construct, install, own, operate, and maintain the facilities required to interconnect the facility to Taxpayer's distribution system. Taxpayer also will engineer, design, procure, construct, install, own, operate and maintain certain upgrades to its distribution system. Generator is responsible for the costs of those assets. The interconnection facilities, the distribution upgrades, and the facilities, together are referred to as the "intertie."

Taxpayer will be the owner and sole operator of the intertie and the intertie will become a permanent part of Taxpayer's transmission and distribution system. Generator has entered into contracts and expects to enter into additional contracts with end users and power marketers to sell power from the facility. Taxpayer represents that the intertie will not be included in Taxpayer's rate base, and that Taxpayer will not take any depreciation deductions with respect to the intertie.

The IRS ruled that the transfer of intertie from Generator to Taxpayer will not be a contribution in aid of construction under section 118(b), but instead will be a nonshareholder contribution to capital excludable from Taxpayer's gross income under section 118(a). The IRS concluded that the deemed contribution of the intertie by Generator to Taxpayer meets the safe harbor requirements of Notice 88-129, which provides that with respect to transfers made by a Qualifying Facility to a utility exclusively in connection with the sale of electricity by the Qualifying Facility to the utility, a utility will not realize income upon transfer of interconnection equipment (intertie) by a Qualifying Facility. Finally, regarding whether the contribution qualifies as a contribution of capital under section 118(a), the IRS stated that the transfer of the intertie by Generator to Taxpayer possesses the characteristics of a nonshareholder contribution to capital as described in *Chicago, Burlington & Quincy Railroad Co.* First, the intertie will become a permanent part of Taxpayer's working capital structure. Second, the transfer is not compensation for services provided for Generator by Taxpayer. Third, the transfer is a bargained-for exchange. Fourth, the transfer will foreseeably result in a benefit to Taxpayer commensurate with its value because the intertie will become part of Taxpayer's transmission system. Fifth, the intertie will be used by Taxpayer in its trade or business for producing gross income.

IRS Requests Comments for 2011-2012 Priority Guidance Plan

The Department of Treasury and the IRS have begun to formulate their Priority Guidance Plan for 2011-2012. In Notice 2001-39 they invited public comment from all interested parties, especially taxpayers, tax practitioners, and industry groups, on recommendations for items that should be included. Projects making the plan become priorities for allocation of resources during the twelve month period from July 2011 through June 2012. The plan also addresses a variety of issues, including recent legislation, the current economic environment, and important international issues. The 2010-2011 plan contained 310 projects, and 25 specific projects under the "Tax Accounting" category.

Companies are encouraged to submit recommendation for items to be included in the 2011-2012 plan. This is an opportunity to influence Treasury and the IRS to prioritize tax issues most important to you and that should be addressed through regulations, revenue rulings, revenue procedures, notices, and other published administrative guidance.

July 1st Deadline for IRS to Rule on Method Change

In Rev. Proc. 2007-67, the IRS provides the procedures for revising the year of change for a non-automatic accounting method change (Form 3115) that is pending at the IRS national office. As a result of these procedural rules, clients should be advised that, in the case of pending Form 3115 filed for the tax year ended December 31, 2010, or for an earlier year, they may have an opportunity to revise the year of change to December 31, 2011. The purpose of this procedure is to allow taxpayers that filed Forms 3115 to avoid the dilemma of deciding which method to use on a tax return if, when the return is filed, the IRS has not yet issued a response to the request for the change in accounting method. The request to revise the year of change is made in writing to the IRS pursuant to section 12.04 of the revenue procedure. If a company takes advantage of this opportunity and revises the year of change, the company must agree to modify the 4-year spread in the case of a positive adjustment. If the original year of change is 2010, the company would take into account one-half of any positive adjustment in the revised year of change (in this case 2011) and one-fourth in each of the remaining two taxable years.

Recent Cases….

Tax Court Rules on Depreciation of Telecom Company Assets

Robert Broz v. Commissioner, 137 T.C. No. 3, is a recently decided Tax Court case that addresses deprecation recovery periods for cellular assets used by a telecommunications company. The assets in question were placed in service in 1996, 1998, 1999, 2000 and 2001. Interestingly, *Broz* addresses the depreciation recovery period of some of the same assets included in the wireless telecommunications industry depreciation safe harbors published by the IRS two months ago in Rev. Proc. 2011-22, which is effective for taxable years ending on or after December 31, 2010. The *Broz* case notes that this revenue procedure was previously issued and goes on to opine on the issues before the court.

In *Broz*, the Tax Court ruled that 1) cellular antenna towers are telephone distribution plant property properly included in asset class 48.14 of Rev. Proc. 87-56 and depreciated over 15 years, 2) switches are computer-based telephone central office equipment included in asset class 48.121 of Rev. Proc. 87-56 and depreciated over 5 years, and 3) base station controllers and other cellular site equipment are telephone central office equipment properly included in asset class 48.12 of Rev. Proc. 87-56 and are depreciated over 10 years. Rev. Proc. 2011-22 differs from the *Broz* case in that cellular antenna towers are personal property with no class life depreciated over 7 years and that base station controllers and other non-switch equipment at the cellular site are computer-based telephone central office equipment depreciated over 5 years.

Given the different recovery periods, and effective dates, provided in *Broz* and Rev. Proc. 2011-22, taxpayers should evaluate their current depreciation recovery periods for wireless telecommunications property to identify any potential opportunities or exposures. An accounting method change may be warranted to eliminate exposure or obtain more favorable depreciation deductions for assets placed in service in prior years.

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