



DEPARTMENT OF THE TREASURY  
INTERNAL REVENUE SERVICE  
WASHINGTON, D.C. 20224

OFFICE OF  
CHIEF COUNSEL

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FREV-245546-96

MEMORANDUM FOR: INDUSTRY DIRECTOR, NATURAL RESOURCES AND  
CONSTRUCTION (LM:NRC)

FROM: CHIEF, BRANCH 6 (CC:PSI:6)  
PASSTHROUGHS AND SPECIAL INDUSTRIES

SUBJECT: DENIAL OF CONSENT FOR CHANGE IN  
ACCOUNTING METHOD

In accordance with section 8.07(2)(a) of Rev. Proc. 2002-1, 2001-1 I.R.B. 1, 34, this Chief Counsel Advice advises you that consent for a change in accounting method has been denied to a taxpayer within your jurisdiction. Pursuant to § 6110 (k)(3), this Chief Counsel Advice is not to be cited as precedent.

LEGEND:

Taxpayer =

Date =

Taxpayer filed the Form 3115, Application for Change in Accounting Method, to request permission to change its method of computing depreciation for certain assets under Rev. Proc. 96-31, 1996-1 C.B. 714. Because this change was under an automatic revenue procedure, Taxpayer may have already made this change.

Taxpayer is a utility involved in the generating, transmitting, and distributing of electricity as well as distribution of gas. Taxpayer previously included certain tools, shop equipment, and laboratory equipment, such as lathes, bandsaws, hydraulic presses, and tools used for testing in asset class 49.13, Electric Utility Steam Production Plant, asset class 49.14, Electric Utility Transmission and Distribution Plant, and asset class 49.21, Gas Utility Distribution Facilities under Rev. Proc. 87-56, 1987-2 C. B. 674.<sup>1</sup>

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<sup>1</sup> For property generally placed in service after 1980 and before 1987 (ACRS property), class lives are described in Rev. Proc. 83-35, 1983-1 C. B. 745. This letter is written in terms of Rev. Proc. 87-56 for property generally placed in service after 1986 (MACRS property). References to Rev. Proc. 87-56, however, should be

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Taxpayer believes these classifications were improper. Specifically, Taxpayer believes that these assets belong in Class A Property, Personal Property With No Class Life, pursuant to Rev. Proc. 87-56 (and Rev. Proc. 83-35).

Former § 168 (ACRS) generally applies to recovery property placed in service after 1980 and before 1987. The term “recovery property” is defined in former § 168(c)(1) as meaning tangible property of a character subject to the allowance for depreciation that is used in a trade or business, or held for the production of income. Recovery property does not include public utility property if the taxpayer does not use a normalization method of accounting.

Pursuant to former § 168(c)(2), each item of recovery property is assigned to one of the classes of property specified in former § 168(c)(2). The term “5-year property” is defined in former § 168(c)(2)(B) as meaning recovery property that is § 1245 class property and that is not 3-year property, 10-year property, or 15-year public utility property. The classification of recovery property as 3-year property, 10-year property, or 15-year public utility property is made with reference to the property’s present class life.

The present class lives of recovery property for purposes of former § 168 are set forth in Rev. Proc. 83-35. This revenue procedure divides assets into two broad categories: (1) asset classes 00.11 through 00.4, which consist of specific depreciable assets used in all business activities; and (2) asset classes 01.1 through 80.0 that consist of depreciable assets used in specific business activities.

The depreciation deduction provided by § 167(a) for tangible property placed in service after 1986 generally is determined under § 168. This section prescribes two methods of accounting for determining depreciation allowances. One method is the general depreciation system in § 168(a) and the other method is the alternative depreciation system in § 168(g). Under either depreciation system, the depreciation deduction is computed by using a prescribed recovery period, depreciation method, and convention.

For purposes of the general depreciation system, the recovery period is determined by the property’s classification under § 168(e). Pursuant to § 168(e)(1), property with a class life of 4 years or less is classified as 3-year property, property with a class life of more than 4 years but less than 10 years is classified as 5-year property, property with a class life of 10 years or more but less than 16 years is classified as 7-year property, property with a class life of 16 years or more but less than 20 years is classified as 10-year property, property with a class life of 20 years or more but less than 25 years is classified as 15-year property, and property with a class life of 25 years or more is classified as 20-year property.

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understood to also be references to Rev. Proc. 83-35. The asset classes discussed in this letter are substantially the same under both revenue procedures.

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The term "class life" is defined in § 168(i)(1) as meaning the class life (if any) that would be applicable with respect to any property as of January 1, 1986, under § 167(m) (determined without regard to § 167(m)(4) and as if the taxpayer had made an election under § 167(m)) as in effect on the day before the date of enactment of the Revenue Reconciliation Act of 1990. Former § 167(m) provided that in the case of a taxpayer who elected the asset depreciation range (ADR) system of depreciation, the depreciation allowance was based on the class life prescribed by the Secretary that reasonably reflected the anticipated useful life of that class of property to the industry or other group.

Section 1.167(a)-11(b)(4)(iii)(b) of the Income Tax Regulations provides rules for classifying property under former § 167(m). Property is included in the asset guideline class for the activity in which the property is primarily used.

The class lives of property subject to depreciation under § 168 are set forth in Rev. Proc. 87-56. This revenue procedure divides assets into two broad categories: (1) asset classes 00.11 through 00.4 that consist of specific depreciable assets used in all business activities; and (2) asset classes 01.1 through 80.0 that consist of depreciable assets used in specific business activities. An asset that falls within both an asset group (that is, asset classes 00.11 through 00.4) and an activity group (that is, asset classes 01.1 through 80.0) is classified in the asset group. See Norwest Corp. & Subs. v. Commissioner, 111 T.C. 105, 156-64 (1998).

Taxpayer's business activity is described in utility asset classes 49.13, 49.14, and 49.21 of Rev. Proc. 87-56. Under the class life system, property generally is included in the asset guideline class for the activity in which the property is primarily used. Taxpayer uses the certain tools, shop equipment, and laboratory equipment, such as lathes, bandsaws, hydraulic presses, and tools used for testing in furtherance of its business activity. Therefore, the assets that Taxpayer wishes to include as Class A Property, Personal Property With No Class Life, are more appropriately included in Taxpayer's specific business activity asset classes.

The method changes would have been effective with the taxable year beginning Date and would have resulted in a negative § 481(a) adjustment/decrease in taxable income.

If you have any questions on this matter, do not hesitate to call me at (202) 622-3110.

CHARLES B. RAMSEY  
Chief, Branch 6  
Office of Associate Chief Counsel  
(Passthroughs & Special Industries)

cc: