



OFFICE OF
CHIEF COUNSEL

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224
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INTERNAL REVENUE SERVICE NATIONAL OFFICE FIELD SERVICE ADVICE

MEMORANDUM FOR
DISTRICT COUNSEL

FROM: DEBORAH A. BUTLER
ASSISTANT CHIEF COUNSEL (FIELD SERVICE)
CC:DOM:FS

SUBJECT: Depreciation / Recovery Period

This Field Service Advice responds to your memorandum dated
Field Service Advice is not binding on Examination or Appeals and is not a final
case determination. This document is not to be cited as precedent.

LEGEND:

- T =
- S =
- Date 1 =
- State 1 =
- River 1 =
- County 1 =
- Building Code 1 =
- Facility =
- Case 1 =

- Case 2 =

- Case 3 =

Case 4 =

Case 5 =

Case 6 =

ISSUES:

1. How strong is the Service's position that the appropriate recovery period, for depreciation purposes, of a Facility built on a barge, with no capacity for water travel, is 31.5 years?
2. What, if any, additional development should be undertaken in the event this case is not settled and litigation is necessary?

CONCLUSIONS:

1. Based upon the Internal Revenue Code, related regulations, relevant case law, and the facts provided, we believe that the [REDACTED]
2. We agree that the factors mentioned in your incoming request are relevant. In addition, we suggest, as detailed below, that certain other factual areas be explored as well.

FACTS:

S, a subsidiary of T, owns and operates a licensed Facility which was constructed on a barge and placed in service on Date 1. The Facility is located in State 1 bordering River 1.

S originally purchased the barge and towed it to a dredged basin one quarter of a mile from River 1. S obtained a permit to cut a farmer's levee to create the channel. The farmer's levee was then rebuilt around the Facility. The basin has a depth of eleven feet. The water level in the basin is maintained at a constant level and is controlled by man-made means by pumping water in and out of the basin.

A twelve inch thick layer of concrete was placed on the upper surface of the barge to create a level construction surface. The three story Facility was then constructed on the barge. The Facility is held in place by four 60-ton hoists by cables that are anchored to the land with concrete caps on piles. The piles are driven into the ground. The Facility has no propulsion system, no rudder, no crew, no captain, and no navigation system. In its current state, the Facility cannot be used for any water transportation.

The Facility is attached to a building which is on the adjacent land. The Facility's roof is a standing seam metal roof which is a common type roof for a building. All the mechanical systems, kitchens, administrative offices, dining areas, and support services are located in the building on the adjacent land. Water, electrical power, and telephone services are provided by local utility companies. The Facility has its own land-based sewage treatment system and percolation field. Moving the Facility would be virtually impossible and prohibitively expensive as it would require the dredging of a new channel, the cutting of the levee, and the use of a tugboat.

A building permit was obtained prior to constructing the Facility. The Facility conforms to and was required to conform to Building Code 1. Further, the Facility is required to meet local fire and safety requirements. The architectural plans were oriented with respect to compass directions just as any building would be. The last Certificate of Inspection from the United States Coast Guard has not been renewed or made up-to-date. The Coast Guard no longer recognizes the barge as a vessel in regard to their authority and regulations.

At issue is the recovery period of the Facility. It is the Service's position that the Facility is nonresidential real property with a recovery period of 31.5 years pursuant to section 168(c), as was in effect for the years at issue. This matter is not docketed and is currently under consideration by Appeals.

LAW AND ANALYSIS

Section 167(a) permits the taxpayer to take depreciation deductions for the exhaustion, wear and tear of property used in the trade or business or of property held for the production of income. For tangible property placed in service after 1986, as is our case, section 168 provides that the depreciation deduction is determined by using the applicable depreciation method, the applicable recovery period, and the applicable convention.

The only issue here is the applicable recovery period. The somewhat complicated mechanics of determining the applicable recovery period are as follows. First, there are ten different potential "recovery periods," which correspond to ten

different classes of property (the depreciable asset). Section 168(c). Four of the classes bear somewhat descriptive titles, such as the class of “nonresidential real property” which had, for the years at issue, a recovery period of 31.5 years. Id. However, the six remaining classes do not have descriptive titles and are labeled only in terms numbers corresponding to their recovery periods: i.e. “three year property,” “five year property,” and so on. Id. These six classes are further described at section 168(e), which defines each of these classes in terms of the “class life” of the property belonging to it. Thus, for example, if a depreciable asset has a class life of sixteen to twenty years, it is “10-year property” under section 168 (e)(1), and has a recovery period of ten years under section 168(c). Next, the term class life is defined by section 168(i)(1), which, in turn, incorporates former section 167(m), which specifically authorized the Commissioner to promulgate regulations regarding class lives of depreciable assets.

The Commissioner did issue regulations, and two rules deriving from them are most pertinent here. First, property is to be classified according to its primary use, even though that use may be insubstantial in relation to all the taxpayer's other activities. Treas. Reg. section 1.167(a)-11(b)(4)(iii)(b). Second, while the regulations did not themselves set out class lives, they left it to the Commissioner to make those determinations in issued Revenue Procedures. Treas. Reg. section 1.167(a)-11(b)(ii). Thus, we come to Rev. Proc. 87-56, 1987-2 C.B. 674, which sets out the current class lives and recovery periods of property subject to section 168 of the Internal Revenue Code for the years at issue.

The essence of the dispute here is that S believes that the proper recovery period for its Facility is to be found in one of the class lives described by Rev. Proc. 87-56, and the Service believes that the Facility is nonresidential real property, which class life is statutorily defined. See Rev. Proc. 87-56, section 5.02

Nonresidential real property is defined as section 1250 property which is not residential rental property or property with a class life of less than 27.5 years. Section 168(e)(2)(B). Section 168(i)(12) provides that 1250 property has the same meaning as given in section 1250(c). Section 1250 property, is defined as any real property, other than section 1245 property, which is or has been of a character subject to the allowance for depreciation provided in section 167. Section 1250(c). Section 1245 property is any property of a character subject to the allowance for depreciation under section 167 and is either (a) personal property, (b) other tangible property (not including a building or its structural components) used in connection with a qualified activity or a research or storage facility used with a qualified activity, (c) a single purpose agricultural or horticultural structure or, (d) a storage Facility used in connection with the distribution of petroleum). Section 1245(a)(3). The terms “buildings” and “structural components” have the meanings

assigned to those terms in Treas. Reg. section 1.48-1(e). Treas. Reg. section 1.1245-3(c)(2).

A building is defined in Treas. Reg. section 1-48.1(e)(1) as any structure or edifice enclosing a space within its walls, and usually covered by a roof, the purpose of which is, for example, to provide shelter or housing, or to provide working, office, parking, display, or sales space. The term includes, for example, structures such as apartment houses, factory and office buildings, warehouses, barns, garages, railway or bus stations, and stores. Such term includes any such structure constructed by, or for, a lessee even if such structure must be removed, or ownership of such structure reverts to the lessor, at the termination of the lease. From the facts provided, the Facility meets this regulatory language. The Facility is comprised of a structural steel frame enclosing a space within its walls and covered by a standing seam metal roof. Further, the purpose of the Facility is to provide working space for its entertainment operations.

Of further relevance in determining whether a structure is a building, are inherent permanency, the appearance, and the function of the structure. See L.L. Bean, Inc. v. Commissioner, T.C. Memo 1997-175. Determining if a structure is inherently permanent requires a consideration of six factors set forth in Whiteco Industries, Inc. v. Commissioner, 65 T.C. 664, 672-73 (1975). Those factors generally are: (1) the manner in which the property is affixed to the real property; (2) whether the property was designed to be easily removable or to remain in place indefinitely; (3) whether the property has been moved since its initial installation or is capable of being moved; (4) any circumstances that suggest the expected period of affixation (e.g., a lease that requires removal of the property upon its expiration); (5) the amount of damage that removal of the property will cause, in terms of time and expense.

From the description of the Facility and the manner of attachment, it is reasonable to infer that S did not contemplate moving the Facility. Compare with Fox Photo Inc. v. Commissioner, T.C. Memo 1990-348. For example, the Facility is held in place by four 60-ton hoists by cables that are anchored to the land with concrete caps on piles. The piles are driven into the ground. Pumps are used to control the water depth in the basin. All the mechanical systems, kitchens, administrative offices, dining areas, and support services are located in the adjacent restaurant building. Water, electrical power, and telephone services are provided by local utility companies. The Facility has its own land-based sewage treatment system and percolation field. The Facility has no capability of independent power generation or utility support. The adjacent building and the Facility are co-dependent and are attached by an enclosed walkway comprised of a concrete gang plank.

From the facts provided, the Facility has not been moved and moving it would be prohibitively expensive and timely. Moving the Facility would have to be done with the consultation of an architectural engineering firm and regulatory and licensing authorities. Further, moving the Facility would require disconnecting all utilities and support systems, dredging channels, provisions for a spoil material receiving area, levee repairs, and compliance with all governmental permits.

The appearance test, whether the structure looks like a building, generally requires a structure enclosing a space within its walls and covered by a roof. See Treas. Reg. section 1.48-1(e)(1); L.L. Bean, Inc., supra. As previously described, in the ordinary sense of the word, the Facility appears to be a “building,” but for the fact that it is not built on land but rather is attached to land. The Facility is a structure which encloses a space within its walls and roof. The Facility was constructed from commonly used building materials. A building permit was obtained from County 1 and the State 1 Commission with jurisdiction requires that the construction comply with Building Code 1.

The function test focuses on whether the structure provides working space for employees that is more than merely incidental to the primary function of the structure. This requires consideration of both the quantity and quality of the human activity in the structure. See L.L. Bean, Inc., supra. As previously discussed, this Facility functions as a structure to house recreation for its customers. The shelter provided to enable the employees to provide entertainment is merely incidental to the primary function of this Facility.

S argues that the Facility is properly classified in asset class 00.28: “vessels, barges, tugs, and similar water transportation equipment, except those used in marine construction.” This asset class has a 10 year recovery period. We believe that this Facility is not described in asset class 00.28 because the primary use of this Facility is clearly not for water transportation. The Facility is a building used solely for entertainment purposes, the construction of which has a barge as a part of its permanent foundation.

Several courts have held that floating Facilities do not constitute “vessels” for purposes of federal admiralty and maritime matters. In Case 1, the Court affirmed the lower court’s judgment holding that a floating dockside Facility was not a vessel for purposes of the Jones Act, 46 App. U.S.C. section 688, or the general maritime law. Finding that the Facility in Case 1 (1) was removed from navigation, and (2) was a work platform, the Court held that under either circumstance, it was not then a vessel for purposes of the Jones Act or the general maritime law.

Similarly, in Case 2, the Court held that Facilities were not vessels within the meaning of 1 U.S.C. section 3 for purposes of the Ship Mortgage Act, 46 U.S.C. section 31301 et seq. The Court stated that to be considered a vessel, “there must be some connections with the business of maritime commerce – an ability to be used for transportation on water...” Case 3. See also Case 4; Case 5; Case 6.

The Facility in issue is landlocked and cannot possibly be engaged in the business of maritime commerce. It is not a vessel for purposes of the Jones Act, 46 App. U.S.C. section 688 and the Ship Mortgage Act, 46 U.S.C. section 31301 et. seq. The Facility is not a vessel in any sense of the word and therefore should not be considered such for purposes of the Internal Revenue Code.

In the alternative, S contends that the depreciable useful life for the structure should be 5 years pursuant to asset class 57.00: “Distributive Trades and Services,” or 7 years under the “No Class Life” category. S’s primary activities do not fit into asset class 57.00 because S does not distribute products or provide services. See also Rev. Proc. 80-15, 1980-1 C.B. 618; Rev. Proc. 77-10, 1977-1 C.B. 548. The “No Class Life” category is not applicable because it applies only for property which is not described by the statute or Rev. Proc. 87-56. Here, the statute, at section 168(c), does set out a recovery period for this property.


Based upon the facts provided, the primary activity of the Facility is otherwise described in asset class 79.00, because that asset class includes assets used in the provision of entertainment services. However, that asset class specifically excludes buildings which house the assets used in entertainment services. The Service believes that the Facility is nonresidential real property with a recovery period of 31.5 years under section 168(c).

CASE DEVELOPMENT, HAZARDS AND OTHER CONSIDERATIONS:

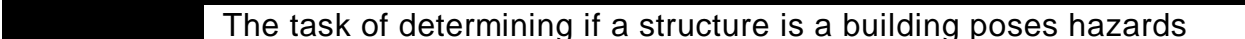
The successful resolution of this case involves intensive factual development because neither section 168, Rev. Proc. 87-56, nor its predecessors, define what assets are considered vessels under asset class 00.28. We encourage you to work closely with your experts to further develop this case.

In drafting this field service advice, we relied primarily on the submitted engineering and valuation report. We believe that the following additional criteria should be considered in developing the Service’s position that this Facility is not a vessel, barge, tug, or similar water transportation equipment under asset class 00.28:

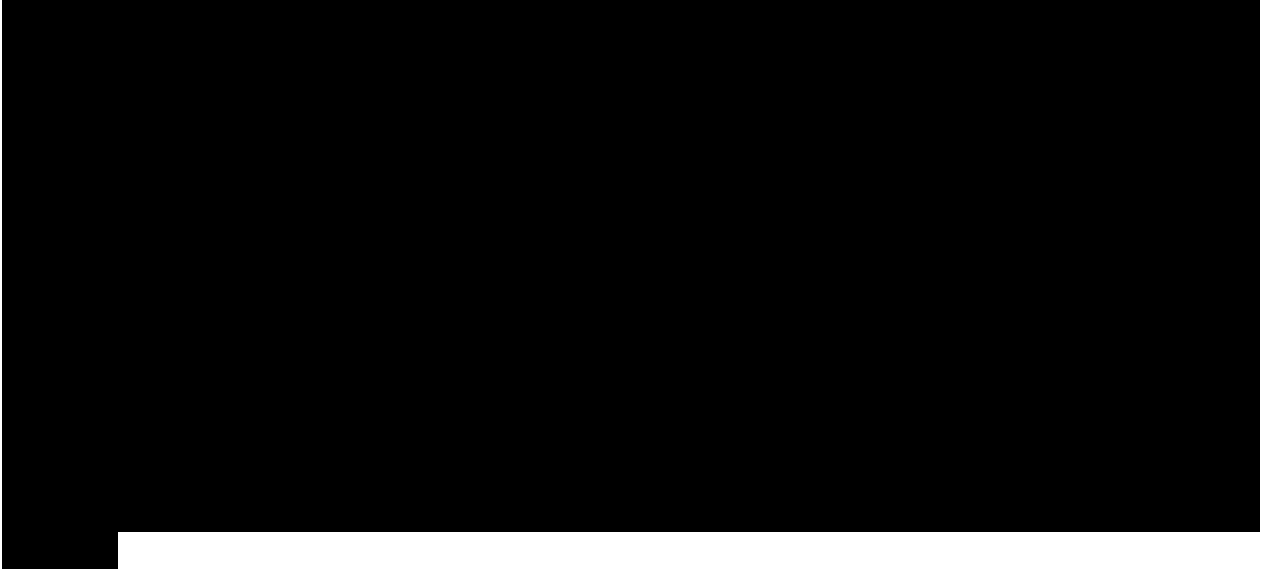




Some of these items were mentioned in the engineering and valuation report but not fully explored. The aforementioned list is not exclusive and is in development. We do not believe that these items are mandatory for every water transportation equipment characterized under asset class 00.28. However, we believe that inquiry into these factors will reveal characteristics more fitting of those found on water transportation equipment in contrast to buildings.



The task of determining if a structure is a building poses hazards due to the factual nature of the issue. The state of the law falls between the Tax Court's more recent and favorable decision in L.L. Bean, supra, (where the court found that a storage facility connected at the mezzanine level to adjacent buildings were inherently permanent) and its unfavorable decision in Fox Photo, T.C. Memo 1990-348, (where the court found that "one-hour photo labs" located in shopping center parking lots were not inherently permanent).



Please call if you have any further questions.

By: _____
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