

Part III

Administrative, Procedural, and Miscellaneous

26 CFR 1.263(a)-1: Capital expenditures; in general.
(Also Part I, §§ 162, 446, 481; 1.167(a)-11, 1.446-1)

Rev. Proc. 2011-27

SECTION 1. PURPOSE

This revenue procedure provides two alternative safe harbor approaches that taxpayers may use to determine whether expenditures to maintain, replace, or improve wireline network assets must be capitalized under § 263(a) of the Internal Revenue Code: a network asset maintenance allowance method or a units of property method. This revenue procedure also provides procedures for obtaining automatic consent to change to either safe harbor method of accounting permitted by this revenue procedure.

SECTION 2. BACKGROUND

.01 Taxpayers that provide wireline telecommunication services incur significant expenditures to maintain, replace, and improve wireline network property. Whether these expenditures are deductible as repairs under § 162 or must be capitalized as improvements under § 263(a) depends on whether the expenditures materially increase

the value of the property or substantially prolong its useful life. See § 1.162-4 of the Income Tax Regulations. Applying capitalization principles to wireline network assets can be particularly difficult, largely because the property consists of a network of interconnected items, such as central office equipment, poles, copper wire, fiber optic cable, and remote and network terminals. Taxpayers and the Internal Revenue Service often do not agree on which items within a network constitute discrete units of property and whether the replacement of a particular item materially increases the value or substantially prolongs the useful life of a unit of property.

.02 To minimize disputes regarding the deductibility or capitalization of expenditures to maintain, replace, or improve wireline network assets, this revenue procedure provides two alternative safe harbor approaches. Section 5 provides a wireline “network asset maintenance allowance method” for determining the amount of expenditures required to be capitalized under § 263(a). Section 6 defines units of property that may be adopted and to which existing principles under § 263(a) are applied.

.03 A taxpayer’s method for determining whether an expenditure is deductible or is capitalizable is a method of accounting under § 446. Except as otherwise expressly provided in the Code and the regulations thereunder, § 446(e) and § 1.446-1(e)(2) require a taxpayer to secure the consent of the Commissioner of Internal Revenue before changing a method of accounting for federal income tax purposes. Section 1.446-1(e)(3)(ii) authorizes the Commissioner to prescribe administrative procedures setting forth the limitations, terms, and conditions necessary to permit a taxpayer to obtain consent to change a method of accounting. Section 7 of this revenue procedure

provides the procedures by which a taxpayer may obtain automatic consent for a change in method of accounting to adopt either of the alternative safe harbor approaches provided by this revenue procedure.

SECTION 3. SCOPE

This revenue procedure applies to a taxpayer that has a depreciable interest in wireline network assets (as described in section 4 of this revenue procedure) used primarily to provide wireline telecommunication or broadband services. This revenue procedure does not apply to a taxpayer that is primarily a cable operator. The determination of whether a taxpayer is within the scope of this revenue procedure is made by each member of a consolidated group, by a partnership, or by an S corporation.

SECTION 4. DEFINITIONS

The following definitions apply solely for purposes of this revenue procedure:

.01 Wireline network assets. “Wireline network assets” means all personal and real property used by a wireline carrier to provide telecommunication or broadband services. Wireline network assets include central office buildings, central office equipment, towers, poles, copper wire, fiber optic cable, service area interface boxes, and remote and network terminals. Wireline network assets do not include personal or real property not directly used to provide wireline telecommunication or broadband services, such as a corporate office building and the furniture and equipment used in an office building.

.02 Wire center. “Wire center” means the wireline network assets located in the geographic area served by a central office (but not including the central office building or central office equipment).

.03 Central office buildings. “Central office buildings” means central office buildings (including their structural components) that house network equipment necessary to provide voice or data services (including video).

.04 Central office equipment. “Central office equipment” means all switching, transmission, and support equipment at a central office building. Central office equipment includes central processors, switching modules, line cards, input/output controllers, optical line terminal equipment, routers, multiplexers, repeaters, amplifiers, digital cross-connect systems, channel banks, modulators, regenerators, signal converters, batteries, generators, HVAC’s required to keep equipment in a central office building at efficient operating levels, and frames that house the equipment where cross connections are made between the outside cable pairs and the central office equipment.

.05 Service area interface. “Service area interface” box (SAI) means an outdoor telecommunications cabinet mounted on the ground (typically on cable right-of-ways) or on telephone poles that protects splice points.

.06 Remote and network terminal. “Remote and network terminal” (RNT) means a terminal located outside the central office building that provides management and maintenance functions, and computes bandwidth profiles used for the wireline network and customer premises equipment.

SECTION 5. NETWORK ASSET MAINTENANCE ALLOWANCE METHOD FOR WIRELINE NETWORK ASSETS

.01 In general. Under the network asset maintenance allowance method, the taxpayer must determine the amount of its wireline network asset expenditures that are not required to be capitalized under section 5.02 of this revenue procedure (network asset maintenance allowance) and the amount of wireline network asset expenditures that are treated as § 263(a) capital expenditures under section 5.03 of this revenue procedure (§ 263(a) capital expenditures). A taxpayer that uses the network asset maintenance allowance method described in this section 5 must use that method for all of its wireline network asset expenditures (which includes expenditures relating to wireline network assets acquired in an applicable asset acquisition as defined in § 1060 or in a transaction to which § 338(h)(10) applies, even though the cost of such property is removed from the total cost of capital additions for the taxable year as provided in § 5.02(2)(b)–(c) below).

.02 Network asset maintenance allowance. The amount of the network asset maintenance allowance for a particular taxable year is determined as follows:

(1) Start with the total cost of capital additions for financial statement purposes that are placed in service (within the meaning of § 1.46-3(d)(1)(ii)) during the taxable year.

(2) Decrease the amount determined in (1) by the following amounts:

(a) the cost of property other than wireline network assets;

(b) the cost of any wireline network assets acquired in an applicable asset acquisition as defined in § 1060; and

(c) the cost of any wireline network assets acquired in a transaction to which § 338(h)(10) applies.

(3) Adjust the amount determined after applying steps (1) and (2) to determine the adjusted basis of the property under § 1011, including any adjustments described in § 1016 except for the following:

(a) Any basis adjustments attributable to changes made after December 31, 2007 to the taxpayer's unit of property definitions used for repair versus capitalization determinations.

(b) Any adjustments described in § 1016(a)(2) and § 1016(a)(3) and any adjustments that require tax basis to be reduced before depreciation is computed (e.g., § 179, § 179D, or similar provisions; § 44 and § 46; and the payments for specified energy property under § 1603 of the American Recovery and Reinvestment Tax Act of 2009, Division B, Pub. L. 111-5, 123 Stat. 115 (section 1603 payments)).

(4) Using the adjusted basis determined in step (3), determine the amount attributable to 5-year, 7-year, 10-year, 15-year, and 20-year property and nonresidential real property, and multiply each of these amounts by 12%. The result is the network asset maintenance allowance for each class of property.

(5) The sum of the network asset maintenance allowances determined in (4) for each class of property is the taxpayer's network asset maintenance allowance amount for the taxable year.

.03 § 263(a) capital expenditures. The wireline network asset capital expenditures for § 263(a) for the taxable year under the network asset maintenance

allowance method are determined as follows:

(1) Start with the adjusted basis for 5-year, 7-year, 10-year, 15-year, and 20-year property and nonresidential real property determined in section 5.02(4) above.

(2) For each class of property, multiply the adjusted basis attributable to the class of property by 88%. The result is each class of property's basis amount after taking into account the network asset maintenance allowance.

(3) For each class of property, allocate that class of property's basis amount determined in 5.03(2) among the class of property's wireline network assets (excluding the wireline network assets acquired in an applicable asset acquisition as defined in § 1060 or in a transaction to which § 338(h)(10) applies) according to the basis of each wireline network asset determined before application of the network asset maintenance allowance.

(4) The amount determined in (3) for each network asset (excluding the wireline network assets acquired in an applicable asset acquisition as defined in § 1060 or in a transaction to which § 338(h)(10) applies) is the basis of such asset to be used to determine the deductions allowable or income tax credits available that require tax basis to be reduced before any depreciation is computed (for example, § 179, § 179D, or similar provisions; § 44 and § 46; and section 1603 payments). The net amount for each network asset after the reduction in basis for such deductions, credits, and section 1603 payments is that property's § 1.168(b)-1(a)(3) unadjusted depreciable basis.

(5) In addition, expenditures for wireline network assets acquired in an applicable asset acquisition as defined in § 1060 or in a transaction to which § 338(h)(10) applies

are capital expenditures under § 263(a) to which the ordinarily applicable basis and holding period rules and regulations apply.

.04 Required schedule. A taxpayer utilizing the wireline network asset maintenance allowance method must attach a schedule to its federal income tax return for the taxable year identifying the amounts for each step of the network asset maintenance allowance method computation provided in sections 5.02(1)-(5) above.

.05 Example. X is a wireline carrier with network assets used primarily to provide wireline telecommunication or broadband services. X adopts the wireline network maintenance allowance method provided in this revenue procedure. To determine the wireline network asset maintenance allowance for the taxable year, X first determines its adjusted basis attributable to wireline network assets as follows:

Total cost of capital additions placed in service for the taxable year per financial statements	\$1,000,000,000
<u>Less</u> : Cost of property other than wireline network assets (e.g. land, intangibles, etc.)	(\$100,000,000)
<u>Less</u> : Cost of assets acquired in a § 1060 or § 338(h)(10) transaction	(\$11,000,000)
<u>Less/Plus</u> : Other basis adjustments (excluding adjustments per IRC §§ 1016(a)(2) & (a)(3) and sections 5.02(3)(a) & 5.03(4) of this rev. proc.)	(\$3,000,000)
Adjusted basis attributable to network assets that are 5-year, 7-year, 10-year, 15-year, and 20-year property and nonresidential real property	\$886,000,000
<u>Multiply by</u> : Maintenance allowance percentage (12%)	X 12%
Network asset maintenance allowance amount	\$106,320,000

SECTION 6. UNITS OF PROPERTY FOR WIRELINE NETWORK ASSETS

.01 In general. For wireline network assets, the Service will not challenge any of the following unit of property determinations for purposes of the application of § 263(a) and the regulations thereunder:

(A) all the towers and poles, and all the structures and fittings mounted on towers and poles, (“fully-dressed poles”) in a wire center constitute a single unit of property;

(B) all the copper wire and any associated devices, whether overhead or underground, in a wire center constitute a single unit of property;

(C) all the fiber optic cable and any associated devices, whether overhead or underground, in a wire center constitute a single unit of property;

(D) all the underground conduit and ducts, as well as controlled environmental vaults (“CEVs”), manholes, and handholes, in a wire center constitute a single unit of property;

(E) each central office building (including its structural components) constitutes a single unit of property;

(F) all central office equipment associated with a central office building constitutes a single unit of property;

(G) all SAI boxes in a wire center constitute a single unit of property; and

(H) all RNTs in a wire center constitute a single unit of property.

.02 Universal adoption not required. A taxpayer within the scope of this revenue procedure is not required to adopt all of the unit of property determinations provided in section 6.01 of this revenue procedure and, therefore, may adopt one or more of the unit of property determinations provided. Once adopted, however, a unit of property determination applies to all similar assets, including similar wireline network assets acquired in an applicable asset acquisition as defined in § 1060 or in a transaction to which § 338(h)(10) applies.

.03 Limitation. The unit of property determinations provided in this revenue procedure shall not apply for any other purpose of the Code or Regulations, including for determining the unit of property under other Code sections (for example, § 263A), or determining the asset for depreciation purposes (including placed in service, retirements, dispositions, or classification under § 168(e) or Rev. Proc. 87-56, 1987-2 C.B. 674), for the same or similar type of assets used in wireline telecommunications or other industries.

SECTION 7. CHANGE IN METHOD OF ACCOUNTING

.01 In general. A change to (1) the wireline network asset maintenance allowance method or (2) adoption of all, or some, of the units of property described in this revenue procedure is a change in method of accounting to which the provisions of §§ 446 and 481, and the regulations thereunder, apply. A taxpayer that wants to change to a method of accounting described in this revenue procedure must use the automatic change in method of accounting provisions in Rev. Proc. 2011-14, 2011-4 I.R.B. 330, or its successor, as modified by this revenue procedure.

.02 Automatic change. Rev. Proc. 2011-14 is modified to add new section 3.07 to the APPENDIX, to read as follows:

.07 Wireline network asset maintenance allowance and units of property methods of accounting under Rev. Proc. 2011-27.

(1) Description of change. This change applies to a wireline telecommunications carrier that is within the scope of Rev. Proc. 2011-27 and wants to change its treatment of wireline network asset expenditures to adopt either (a) the wireline network asset maintenance allowance method of accounting or (b) all, or some, of the units of property

described in Rev. Proc. 2011-27.

(2) Waiver of scope limitations. The scope limitations in section 4.02 of this revenue procedure do not apply to a wireline telecommunications carrier that changes to a method of accounting provided in section 5 or section 6 of Rev. Proc. 2011-27 for its first or second taxable year ending after December 30, 2010.

(3) Section 481(a) adjustment. In general, a change to the wireline network assets maintenance allowance method of accounting or adoption of all, or some, of the units of property specified in Rev. Proc. 2011-27 requires an adjustment under § 481(a). The § 481(a) adjustment shall not include any amount attributable to property for which the taxpayer elected to apply the repair allowance under § 1.167(a)-11(d)(2).

(4) Ogden copy of Form 3115 required in lieu of national office copy. A taxpayer changing its method of accounting under section 3.07 of the APPENDIX must file a signed copy of its completed Form 3115 with the IRS in Ogden, UT, (Ogden copy) in lieu of filing the national office copy no earlier than the first day of the year of change and no later than the date the taxpayer files the original Form 3115 with its federal income tax return for the year of change. See section 6.02(3)(a)(ii)(B) (providing the general rules) and section 6.02(7)(b) (providing the mailing address) of this revenue procedure.

(5) Designated automatic accounting method change number. The designated automatic accounting method change number for a change to the method of accounting provided in Rev. Proc. 2011-27 is “158.”

(6) Contact information. For further information regarding a change under this section, contact Alan S. Williams at (202) 622-4950.

SECTION 8. EFFECT ON OTHER DOCUMENTS

Rev. Proc. 2011-14 is modified to include the accounting method change in this revenue procedure in section 3 of the Appendix.

SECTION 9. EFFECTIVE DATE

This revenue procedure is effective for taxable years ending on or after December 31, 2010.

SECTION 10. DRAFTING INFORMATION

The principal author of this revenue procedure is Alan S. Williams of the Office of Associate Chief Counsel (Income Tax & Accounting). For further information regarding this revenue procedure, contact Alan S. Williams at (202) 622-4950 (not a toll free call).