

Checkpoint Contents

 Federal Library

 Federal Source Materials

 IRS Rulings & Releases

 Revenue Rulings & Procedures, Notices, Announcements, Executive & Delegation Orders, News

 Releases & Other IRS Documents

 Revenue Procedures (1955 to Present)

 2011

Rev. Proc. 2011-43, 2011-37 IRB 326 -- IRC Sec(s). 446, 08/19/2011

Revenue Procedures

Rev. Proc. 2011-43, 2011-37 IRB 326, 08/19/2011, IRC Sec(s). 446

Methods of accounting-automatic consent procedures.

Headnote:

Due to difficulty inherent in determination whether expenses to maintain, replace, or improve electrical transmission and distribution property must be capitalized under **Code Sec. 263(a)**, IRS has established safe harbor accounting method that classifies property as either linear or non-linear and defines "units" of both types. Several specified expenditures must be capitalized per se. **Rev. Proc. 2011-14, 2011-4 IRB 330** is modified to include this change in accounting method.

Reference(s): [¶ 4465.22\(5\); Code Sec. 446;](#)

Full Text:

1. Purpose

This revenue procedure provides a safe harbor method of accounting that taxpayers may use to determine whether expenditures to maintain, replace, or improve electric transmission and distribution property must be capitalized under  § 263(a) of the Internal Revenue Code. This revenue procedure also provides procedures for obtaining automatic consent to change to the safe harbor method of

accounting.

2. Background

.01. Taxpayers that transmit and distribute electricity incur significant expenditures to maintain, replace, and improve transmission and distribution 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 electric transmission and distribution property can be particularly difficult, largely because the property consists of a network of interconnected items such as poles, conductor, and transformers. Taxpayers and the Internal Revenue Service often do not agree on which items within this 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 transmission and distribution property, this revenue procedure provides a "transmission and distribution property safe harbor method of accounting" for determining the amount of expenditures required to be capitalized under  § 263(a). This revenue procedure classifies transmission and distribution property as either linear property (for example, conductor, poles) or non-linear property (for example, transformers, customer electric meters). For linear property, this revenue procedure defines the appropriate units of property and provides a simplified method of determining when the cost of replacing a portion of a unit of linear property must be capitalized. For non-linear property, this revenue procedure defines the appropriate units of property but does not provide a simplified method of determining when the cost of replacing a portion of a unit of non-linear property must be capitalized. Taxpayers must follow the principles of  § 263(a) to determine whether the replacement of a portion of a non-linear unit of property is deductible or capitalizable. This revenue procedure also identifies certain expenditures that are per se treated as capital expenditures.

.03. A taxpayer's method for determining whether an expenditure is deductible or is capitalizable is a method of accounting under  § 446.  Section 446(e) and  § 1.446-1(c) require taxpayers to secure the consent of the Commissioner 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.

3. Scope

This revenue procedure applies to a taxpayer that-

- (1) has a depreciable interest in electric transmission or distribution property (as described in section 4 of this revenue procedure) used primarily to transport, deliver, or sell electricity; and
- (2) applies the transmission and distribution property safe harbor method of accounting provided in this revenue procedure to all of its electric transmission and distribution property as defined in this revenue procedure. 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.

4. Definitions

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

- .01. Linear property. "Linear property" means all electric transmission and distribution property except non-linear property.
- .02. Non-linear property. "Non-linear property" means all electric transmission and distribution property that is substation property, storage battery property, line transformers, customer electric meters (including smart electric meters), or property installed on a customer's premises.
- .03. Electric transmission and distribution property. "Electric transmission and distribution property" means real and personal property that is used to conduct and control electricity at any point between an electric generating station and the location of consumption of the electricity by the customer. The electric generating station is not included in this definition. Examples include wires (conductor), towers, poles, structures and fittings mounted on towers and poles, electrical interrupters (such as circuit breakers, fuses, and other switches), transformers, capacitors, instrumentation, security structures, and pads on which equipment is mounted. In addition and solely for the purposes of this revenue procedure, electric transmission and distribution property includes (a) street lighting and (b) traffic and similar signal systems. Electric transmission and distribution property does not include personal or real property, such as a corporate office building, not directly used to conduct and control electricity.
- .04. Substation property. "Substation property" means transformers and devices (such as fuses, breakers, other switches, insulators, fencing, walls, and enclosures or other structures) that are installed at an electrical substation, i.e., a subsidiary station of an electricity generation, transmission, and distribution system where voltage is transformed from high to low, or the reverse, using transformers.
- .05. Storage battery property. "Storage battery property" means one or more interconnected batteries and the devices that connect the batteries to other transmission and distribution property.
- .06. Line transformer. "Line transformer" means the electrical device that causes an interim or final reduction of the voltage of electricity to the voltage at which the electricity is delivered to one or more customers. Line transformers are typically located on a pole when overhead service is provided or in a

box or vault when underground service is provided. A transformer located at a substation is not a line transformer.

.07. Customer electric meter. "Customer electric meter" means the device that measures the amount of electricity delivered to a customer. In addition to traditional electric meters, this term includes smart electric meters, advanced electric meters that enable two-way communication between the electric meter and the central system for monitoring and billing purposes.

.08. Property installed on a customer's premises. "Property installed on a customer's premises" means the devices, such as electrical usage controls on appliances, which are owned by the taxpayer but installed on property owned by the taxpayer's customer (excluding customer electric meters).

.09. Circuit. "Circuit" means the linear property: (1) between a generating station and the initial substation; (2) between any two substations; or (3) between the final substation (the last substation before the line transformer) and the customer's electric meter.

.10. Blanket work order procedure. "Blanket work order procedure" means a procedure under which a taxpayer charges multiple replacements over a specific period of time to a single work order.

5. Transmission And Distribution Property Safe Harbor Method Of Accounting

.01. In general. A taxpayer using the transmission and distribution property safe harbor method provided by this revenue procedure must determine its units of transmission and distribution property as provided in section 5.02 of this revenue procedure. For each replacement of a portion of a unit of linear property, the taxpayer must determine whether more than 10 percent of the unit of linear property is replaced. If more than 10 percent of the unit of linear property is replaced, the cost of the replacement must be capitalized. If 10 percent or less of the unit of property is replaced, the cost of the replacement is not required to be capitalized under  § 263(a). In general, individual replacements within a circuit are not aggregated in determining the percentage of a unit of linear property replaced. But see section 5.04 of this revenue procedure for situations where aggregation is required. The safe harbor method described in this section 5 provides the exclusive means for taxpayers using the transmission and distribution property safe harbor method to determine whether an expenditure for linear property is deductible or must be capitalized.

.02. Units of property.

(1) Units of linear property. For purposes of this revenue procedure, the "unit of linear property" is determined on a circuit-by-circuit basis; each circuit contains the following eight units of linear property:

(a) All conductor and any associated devices, whether overhead or underground, used to conduct electricity (not including customer service lines and substation property) constitute a single unit of

linear property.

- (b) All towers and poles and all structures and fittings mounted on towers and poles ("fully-dressed poles") (not including the line transformers) constitute a single unit of linear property.
- (c) All underground conduit constitutes a single unit of linear property.
- (d) All boxes and vaults, and structures and fittings mounted in boxes or vaults (not including the line transformers) constitute a single unit of linear property.
- (e) All the customer service drops (the conductor and any associated devices running from a utility pole or underground box or vault to a customer's building or other premises) constitute a single unit of linear property.
- (f) All the street lighting constitutes a single unit of linear property.
- (g) All the traffic and similar signal systems constitute a single unit of linear property.
- (h) All the smart grid property (as defined in  § 168(i)(19)(B)) not located at a substation (including access points, relays, and e-bridges, but excluding smart electric meters) constitutes a single unit of linear property.

(2) Units of non-linear property. For purposes of this revenue procedure, the following are the units of property for non-linear property:

- (a) Each transformer at a substation constitutes a single unit of non-linear property.
- (b) All fencing, walls, enclosures, other structures surrounding each substation or supporting the substation electrical devices (excluding enclosures or buildings suitable for occupation), and land improvements that are not properly capitalized to land constitute a single unit of non-linear property.
- (c) Each set of installed storage battery property constitutes a single unit of non-linear property.
- (d) All smart grid property, as defined in  § 168(i)(19)(B), located at each substation constitutes a single unit of non-linear property.
- (e) All other electrical devices at each substation, such as fuses, breakers, other switches, regulators, insulators, meters, and the pad on which the equipment is installed constitute a single unit of non-linear property.
- (f) Each line transformer constitutes a single unit of non-linear property.
- (g) Each customer electric meter (including each smart electric meter) constitutes a single unit of non-linear property.
- (h) All other property installed on each customer's premises (i.e., all installations on a single premises) constitutes a single unit of non-linear property.

.03. Determining the percentage of a unit of linear property replaced.

(1) In general. The percentage of a unit of linear property replaced is determined based on the number of items (or other denominating factor) existing in a unit of property at the beginning of a taxable year as follows:

- (a) For conductor and associated devices used to conduct electricity (not including customer service lines), the number of feet of conductor replaced is divided by the number of feet of conductor in the unit of property (for example, if 100 feet of conductor is replaced in a circuit that contains 2000 feet of

conductor, the percentage of the conductor replaced is 5 percent [$100 / 2000 = .05$]).

(b) For poles and towers, the number of poles and towers replaced is divided by the number of poles and towers in the unit of property.

(c) For underground conduit, the number of feet of conduit replaced is divided by the number of feet of conduit in the unit of property.

(d) For boxes and vaults, the number of boxes and vaults replaced is divided by the number of boxes and vaults in the unit of property.

(e) For customer service drops, the number of customer service drops replaced is divided by the number of customer service drops in the unit of property.

(f) For street lighting, the number of street lights replaced is divided by the number of street lights in the unit of property.

(g) For traffic and similar signal systems, the number of traffic and similar signals replaced is divided by the number of traffic and similar signals in the unit of property.

(h) For smart grid property as defined in  § 168(i)(19)(B), but excluding smart electric meters as

defined in  § 168(i)(18)(B), the historical cost of smart grid devices replaced is divided by the historical cost of the smart grid unit of property.

(2) Per se capital expenditures excluded. For purposes of determining whether more than 10 percent of a unit of linear property is replaced, replacements that are required to be capitalized under section 5.06 of this revenue procedure are excluded (i.e., per se capital expenditures are not included in either the numerator or the denominator of the ratio used to determine the percentage of a unit of property replaced).

(3) Transition rule. For the first three taxable years ending on or after December 31, 2010, a taxpayer using the transmission and distribution property safe harbor method provided by this revenue procedure may determine the percentage of a unit of linear property replaced on the basis of an average circuit within a county.

.04. Aggregation requirement.

(1) Aggregation rule. For purposes of determining whether more than 10 percent of the unit of linear property is replaced, a taxpayer must aggregate multiple replacements within a circuit if-

(a) the replacements are initiated at the same time;

(b) the replacements are required by the occurrence of a single event; or

(c) a regulatory commission decision authorizes the replacements as part of an identified program aimed at a specific purpose.

(2) Initiated at the same time. Specific multiple replacements are initiated at the same time by any action that provides the final approval for the physical conduct of the replacements. In general, such final approval includes the issuance of a work order under the taxpayer's operating procedures that authorizes workers to perform the replacements. However, work orders that authorize a replacement before the need for the replacement is identified by the taxpayer, such as a blanket work order, do not constitute final approval for the physical conduct of the replacement.

.05. Special rules for blanket work orders.

(1) Allocation of costs among circuits. A taxpayer that uses a blanket work order procedure may use the following simplifying assumptions for purposes of determining whether more than 10 percent of the unit of linear property in a circuit is replaced:

(a) A taxpayer that replaces property in multiple circuits and charges the replacements to a single blanket work order may allocate the replacements among the multiple circuits either (1) on a pro-rata basis (equally among the circuits) or (2) proportionately based on the length of each circuit.

(b) A taxpayer whose blanket work order procedure uses a standard cost accounting system may determine the number of replacements charged to a blanket work order by dividing the total cost of replacements charged to the blanket work order by the applicable standard cost.

(c) A taxpayer whose blanket work order system accumulates the dollars expended under the blanket work order, but not the quantity of replacements, may determine the percentage of a unit of linear property replaced by dividing the total dollar amount charged to the blanket work order for replacements to the linear unit of property over a fixed period of time by the total replacement cost of the whole unit of linear property. The fixed period of time used for the calculation cannot exceed one year.

(2) Blanket work order de minimis rule. A taxpayer that adheres to a policy that limits per-event charges under a blanket work order procedure to replacements of property costing \$50,000 or less is not required to capitalize the costs of linear property replacements charged to the blanket work order.

.06. Per se capital expenditures. The following expenditures must be capitalized, notwithstanding any other provision of this revenue procedure:

(1) The costs of replacing overhead conductor with underground conductor within a circuit, regardless of the percentage of conductor in the circuit that is replaced.

(2) The costs of property necessary to add one or more new customers.

(3) The costs of property that materially increases rated capacity (i) in a unit of property or (ii) to one or more customers.

(4) The costs of property that extends an existing circuit.

.07. CLADR percentage repair allowance exclusion. An eligible taxpayer that changes its treatment of transmission and distribution property expenditures to adopt the safe harbor method described in this revenue procedure may not elect the Class Life Asset Depreciation Range System (ADR) repair allowance under  § 1.167(a)-11(d)(2) in any taxable year that the taxpayer uses the safe harbor method permitted under this revenue procedure. In addition, for any taxable year in which the  § 1.167(a)-11(d)(2) repair allowance election was made, the safe harbor method described in section 5.01 of this revenue procedure may not be applied to change the taxpayer's treatment of property to which the taxpayer elected to apply the repair allowance under  § 1.167(a)-11(d)(2).

.08. Statistical sampling. By following the sampling procedures provided in Rev. Proc. 2011-42, taxpayers

adopting the safe harbor method of accounting provided in this revenue procedure may use statistical sampling to determine whether costs to maintain, replace, and improve transmission and distribution property are deductible as repairs under  § 162 or must be capitalized as improvements under  § 263(a). Sampling methodologies not described in Rev. Proc. 2011-42 are not permitted under the transmission and distribution property safe harbor method of accounting.

6. Examples

The following examples illustrate the application of this revenue procedure. In each example, it is assumed that X, the taxpayer, files its federal income tax return on a calendar year basis and uses the transmission and distribution property safe harbor method of accounting provided by this revenue procedure.

Example 1. On July 20 of Year 1, X received authorization from its regulatory commission to replace a number of defective poles in Circuit A, which consists of 2,000 poles in total. On July 21 of Year 1, X approves the replacement of and replaces three of the defective poles. On July 22 of Year 1, X approves the replacement of and replaces two additional defective poles. Although final approval of the July 21 and July 22 replacements occurred on different days, the replacements are aggregated because the replacement of all five poles was required by a single event, the July 20 authorization. X's cost of replacing the five poles is currently deductible because the replacement of five poles represents 0.25 percent of the poles in Circuit A, which is 10 percent or less of the poles in the circuit.

Example 2. In addition to the facts provided in Example 1, in response to a regulatory commission decision rendered in a prior year to replace utility poles with fungus damage, between November 1 of Year 1 and January 21 of Year 2, X replaces 500 poles in Circuit A. X authorized the replacement of the 500 poles through the issuance of two work orders: one that authorized the replacements made in Year 1 and another that authorized the replacements made in Year 2. The replacements are aggregated, however, because the replacement of all 500 poles was required by the regulatory commission decision. X's costs of replacing the 500 poles are capital expenditures because the replacement of 500 poles represents 25 percent of the poles in Circuit A, which is more than 10 percent of the poles in the circuit.

Example 3. In addition to the facts provided in Examples 1 and 2, during a routine inspection of Circuit A, X determined that 50 poles were unstable. X replaces the 50 unstable poles on December 15 of Year 1. The pole replacement project was authorized by managers on the day the work crews were assigned and the poles were replaced. X's costs of replacing the 50 poles are currently deductible because the replacement of 50 poles represents 2.5 percent of the poles in the circuit, which is 10 percent or less of the poles in the circuit.

Example 4. In addition to the facts provided in Examples 1-3, Circuit A contains five miles (26,400 feet) of overhead conductor. During Year 1, X initiates two separate projects: one to replace 2,000 feet of overhead conductor with new overhead conductor and one to replace 150 feet of overhead conductor

with underground conductor. X's costs of replacing the 2,000 feet of overhead conductor are currently deductible because the replacement of 2,000 feet of conductor represents 7.6 percent of the conductor in Circuit A, which is 10 percent or less of the conductor in Circuit A. X's costs of replacing 150 feet of overhead conductor with underground conductor are capital expenditures because, even though X replaced less than 0.6 percent of the conductor in Circuit A, the costs of replacing overhead conductor with underground conductor must be capitalized. If these two replacement projects occurred as part of one single project, the length of replacement conductor required to be capitalized under section 5.06 of this revenue procedure would be excluded from both the numerator and the denominator of the ratio used to determine the percentage of conductor replaced in Circuit A.

Example 5. X uses a blanket work order system under which certain replacements or additions are charged to blanket work orders. X follows its policy limiting per event charges to blanket work orders to replacements of linear property costing \$50,000 or less. The cost of linear property replacements charged on these blanket work orders are accumulated over the full tax year and then are charged to X's accounts. In Year 1, X charges \$800,000 of linear property replacements to blanket work orders. Because X adheres to a policy that limits the per event charges to blanket work orders to replacements of linear property costing \$50,000 or less, X may deduct the \$800,000 of linear property replacements charged to the blanket work orders in Year 1.

Example 6. X owns Circuit B, which serves at the outer edge of a growing residential community. A plat exists for housing development P, on which construction has not begun. Circuit B contains 2,000 poles. On March 1 of Year 1, X receives authorization to extend Circuit B to serve housing development P. X extends Circuit B between May and September of Year 1, placing 180 poles into service as part of Circuit B. X's costs of placing 180 poles into service as part of Circuit B are capital expenditures because, even though X increased the number of poles in Circuit B by less than 10 percent, the costs of extending an existing circuit must be capitalized.

7. Change In Method Of Accounting

.01. In general. A change to the transmission and distribution property safe harbor method 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 the method of accounting described in this revenue procedure must use the automatic change in method of accounting provisions in Rev. Proc. 2011-14, or its successor, as modified by this revenue procedure.

.02. Statistical sampling and extrapolation. Taxpayers adopting the safe harbor method of accounting provided in this revenue procedure may use statistical sampling to determine the  § 481(a) adjustment amount attributable to any single taxable year by following the sampling procedures provided in Rev. Proc. 2011-42. In addition, taxpayers adopting the safe harbor method of accounting provided in this revenue procedure may extrapolate results to determine the  § 481(a) adjustment amount for certain

years by following the relevant procedures provided in Appendix A to this revenue procedure. Sampling or extrapolation methodologies not described in Rev. Proc. 2011-42 or Appendix A to this revenue procedure are not permitted under the safe harbor method of accounting.

.03. Automatic change. Rev. Proc. 2011-14 is modified to add new section 3.09 to the APPENDIX, to read as follows:

Method of accounting under Rev. Proc. 2011-43 for taxpayers in the business of transporting, delivering, or selling electricity.

- (1) Description of change. This change applies to a taxpayer that is within the scope of Rev. Proc. 2011-43 and wants to change its treatment of transmission and distribution property expenditures to adopt the method of accounting described in Rev. Proc. 2011-43.
- (2) Waiver of scope limitations. The scope limitations in section 4.02 of this revenue procedure do not apply to an electric transmission or distribution company that changes to the method of accounting provided in Rev. Proc. 2011-43 for its first or second taxable year ending after December 30, 2010.
- (3) Section 481(a) adjustment. A taxpayer must take the entire net § 481(a) adjustment into account (whether positive or negative) in computing taxable income in the year of change. 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) for any taxable year in which the election was made. For guidance regarding permissible § 481(a) calculation methodologies, see Rev. Proc. 2011-43, section 7.02 and Appendix A.
- (4) Ogden copy of Form 3115 required in lieu of national office copy. A taxpayer changing its method of accounting under section 3.09 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 sections 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 numbers. The designated automatic accounting method change number for a change to the method of accounting provided in Rev. Proc. 2011-43 is "160."
- (6) Contact information. For further information regarding a change under this section, contact Alan S. Williams at (202) 622-4950 (not a toll free call).

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.

9. Effective Date

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

10. Drafting Information

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

Appendix A

Sampling and Extrapolation Guidance

1. Introduction

.01. In general. This appendix provides an extrapolation methodology an eligible taxpayer may use to adopt the safe harbor method of accounting provided by this revenue procedure.

.02. Statistical sampling. A taxpayer who either is filing an original return or is under examination may use statistical sampling and sampling estimates, as provided in Rev. Proc. 2011-42, as part of the safe harbor method of accounting provided in this revenue procedure.

.03. Extrapolation. A taxpayer desiring to change its treatment of transmission and distribution property expenditures to adopt the safe harbor method of accounting described in this revenue procedure may use the extrapolation procedures provided in this Appendix A for purposes of determining the proper  § 481(a) adjustment resulting from properly making a change in method of accounting. The extrapolation methodology described in this Appendix A provides the exclusive extrapolation methodology that is permitted under the safe harbor method of accounting provided in this revenue procedure.

2. Extrapolation Methodology

.01. In general. A taxpayer using the safe harbor method of accounting provided by this revenue procedure may use the extrapolation procedures provided in this Appendix A for purposes of redetermining, in connection with calculating a  § 481(a) adjustment, whether costs to maintain, replace, and improve transmission and distribution property are deductible as repairs under  § 162 or

must be capitalized as improvements under  § 263(a).

.02. Calculation methodology. In order to determine the amount of the  § 481(a) adjustment for a year in which extrapolation is applied, the following calculation methodology must be utilized:

- (1) First, a repair deduction percentage shall be computed as follows using data from a minimum of the three most recent taxable years, including the year of change (" testing period").
 - (a) For each taxable year of the testing period, the sum of deductible repair expenses under the safe harbor method provided in this revenue procedure must be reduced by the sum of the repair expenses the taxpayer had taken under its method of accounting prior to application of the safe harbor. The results of this subtraction are added together into a total sum of additional (or reduced) deductions resulting from the application of the safe harbor method during the testing period.
 - (b) The total sum of additional (or reduced) deductions calculated in step (a) is divided by the sum of all capital additions during the testing period. The resulting ratio represents the weighted average percentage of capitalized additions that are properly treated as additional (or reduced) deductible repair expenses (" tentative repair deduction percentage"). For this purpose, to determine the sum of all capital additions taxpayers shall use capital additions for financial statement purposes.
 - (c) Multiply the tentative repair deduction percentage by a haircut percentage for each taxable year prior to the testing period for which the taxpayer will use extrapolation. For each taxable year that extrapolation is used the haircut percentage is determined by using the formula $(1 - (0.10 * (\underline{X}/\underline{Y}))$ where X equals the number of years the extrapolation year precedes the year of change and Y equals the total of number of taxable years in the testing period. The haircut percentage for a taxable year multiplied by the tentative repair deduction percentage equals the repair deduction percentage for the taxable year.
- (2) Second, a repair deduction amount for each taxable year outside the testing period (for which extrapolation is being used) shall be calculated by multiplying the repair deduction percentage for the taxable year by the capital additions for the year (except property which was subject to the repair allowance under  § 1.167(a)-11(d)(2)). For this purpose, capital additions must include all basis adjustments required by  § 1011 (including any applicable audit adjustments for the taxable year) except for the following:
 - (a) any adjustments that require tax basis to be reduced before depreciation is computed (e.g.,  § 179,  § 179D, or similar provisions;  § 44 and  § 46, or similar provisions), and
 - (b) adjustments described in  § 1016(a)(2) and  § 1016(a)(3).
- (3) Basis adjustments required by  § 1011 include, but are not limited to, the following:
 - (a) adjustments resulting from a change in accounting method permitted under Rev. Proc. 2000-7, 2000-1 C.B. 712, involving the treatment of the costs incurred in removing retired assets;
 - (b) adjustments resulting from a change in the treatment of capitalized amounts determined under

§ 263A, including reductions for additional mixed service costs allocated to inventory and adjustments to account for changes to interest capitalization amounts;

(c) adjustments arising from casualty loss deductions recognized under § 165; and

(d) adjustments resulting from research and experimental expenditures deducted under § 174.

(4) The basis of electric transmission and distribution property calculated after taking into account the repair deduction basis adjustment and other basis adjustments under section 2.02(2) above is the basis that should 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; or similar provisions). The net amount for each asset after the reduction in basis for such deductions and credits is that property's § 1.168(b)-1(a)(3) unadjusted depreciable basis, which is the basis before taking into account § 1016(a)(2) and (3) adjustments.

(5) For each taxable year in which the § 1.167(a)-11(d)(2) repair allowance election was made, the repair deduction amount determined in section 2.02(2) of this Appendix A for the taxable year must exclude additional repairs attributable to property for which the taxpayer elected to apply the § 1.167(a)-11(d)(2) repair allowance. To determine the amount to exclude from the § 481(a) adjustment, taxpayers must use a method comparable to the method actually used to allocate qualified repair expenditures to repair allowance property for that year. For example, if in applying § 1.167(a)-11(d)(2)(b) for the 1997 taxable year a taxpayer determined that 73 percent of its 1997 qualified repair expenditures were attributable to eligible repair allowance property, then that same percentage (73%) must be applied to determine the reduction to the repair deduction amount otherwise calculated under section 2.02(2) of this Appendix A.

(6) The § 481(a) adjustment must account for any tax credit and depreciation deduction adjustments in each taxable year resulting from the additional (or reduced) repair deductions claimed under the safe harbor method provided in this revenue procedure.

.03. Consecutive year requirement. Under the extrapolation calculation methodology, if sufficient data is available to calculate the repair deduction percentage for more than three years, the taxpayer may use data from such additional years only if the additional years are consecutive to the testing period and prior to the year of change.

.04. Representative years required. The data from the taxable years used to calculate the repair deduction percentage must be representative of all years included in the § 481(a) adjustment.

(1) In determining whether the sampled years are representative, a taxpayer must take into account

restructuring transactions including acquisitions and dispositions, as well as any other events that may have triggered large capital additions.

(2) If events or transactions create an aberration in a sampled year, then consideration should be given to expanding the sampled years, expanding the number of sample items drawn from that year, or removing the year from the sample.

.05. Example.

.05. X changes its method of accounting to the transmission and distribution property safe harbor method of accounting in 2010. X uses the extrapolation methodology provided in section 2 of this Appendix A to determine the amount of its  § 481(a) adjustment attributable to taxable years 2007 through 2001. X's capital additions for financial statement purposes for 2002 are \$10,000. In 2002 X elected to apply the repair allowance under  § 1.167(a)-11(d)(2), which applied to 25% of X's transmission and distribution property.

Step 1. X calculates its tentative repair deduction percentage using data from the three consecutive taxable years 2010, 2009, and 2008. Capital additions for financial statement purposes properly treated as additional deductible repair expenses resulting from the application of the safe harbor method for 2010, 2009, and 2008 are \$500, \$300, and \$200, respectively. Capital additions for financial statement purposes for 2010, 2009, and 2008 are \$ 6,000, \$3,000, and \$1,000, respectively. The tentative repair deduction percentage is computed as follows:

$$\$1,000/\$10,000 = 10\%$$

Step 2. X calculates the haircut percentage for each taxable year that extrapolation is used using the formula $(1 - 0.10 * (X/Y))$, where X equals the number of years the extrapolation year precedes the year of change and Y equals the total of number of taxable years in the testing period. The haircut percentage for each taxable year that extrapolation is used is calculated as follows:

Taxable Year	Haircut Percentage Calculation (Step A)	Haircut Percentage Calculation (Step B)
2007	$0.10 * (3/3) = 0.10$	$1 - 0.10 = 0.90 = 90\%$
2006	$0.10 * (4/3) = 0.133$	$1 - 0.133 = 0.867 = 86.7\%$
2005	$0.10 * (5/3) = 0.167$	$1 - 0.167 = 0.833 = 83.3\%$
2004	$0.10 * (6/3) = 0.20$	$1 - 0.20 = 0.80 = 80\%$
2003	$0.10 * (7/3) = 0.233$	$1 - 0.233 = 0.767 = 76.7\%$
2002	$0.10 * (8/3) = 0.267$	$1 - 0.267 = 0.733 = 73.3\%$

Taxable Year	Haircut Percentage Calculation (Step A)	Haircut Percentage Calculation (Step B)
2001	0.10 * (9/3) = 0.30	1 - 0.30 = 0.70 = 70%

Step 3. X 's repair deduction percentage for 2002 is 7.33%, which is computed by multiplying the tentative repair deduction percentage (10%) by the haircut percentage for 2002 (73.3%).

Step 4. X 's repair deduction amount for 2002 before additional tax adjustments and exclusion of additional repairs attributable to property for which the taxpayer elected to apply the § 1.167(a)-(11)(d)(2) repair allowance is \$733 ($\$10,000 * 7.33\%$).

Step 5. X determines that tax adjustments reduce the 2002 calculated repair deduction amount by \$33. X reduces the calculated repair deduction amount for 2002 by \$33, resulting in a repair deduction of \$700 before excluding repair amounts attributable to property for which the taxpayer elected to apply the § 1.167(a)-(11)(d)(2) repair allowance.

Step 6. X must reduce its repair deduction amount for 2002 to exclude additional repairs attributable to property for which the taxpayer elected to apply the § 1.167(a)-11(d)(2) repair allowance. In 2002, X determined that 25 percent of its 2002 qualified repair expenditures were attributable to eligible transmission and distribution property. Therefore, X reduces the repair deduction amount for 2002 by 25%. Accordingly, X reduces the \$700 calculated through Step 5 by \$175 ($\$700 * 25\%$), resulting in a repair deduction amount for 2002 of \$525 ($\$700 - \175).

Step 7. To determine its § 481(a) adjustment amount for 2002, X must account for its decreased depreciation deductions resulting from the additional \$525 of deductible repair expenditures resulting from the application of the safe harbor method. Assuming that the additional \$525 of deductible repair expenditures for 2002 results in a \$300 reduction in depreciation deductions through the year of change, X 's § 481(a) adjustment amount attributable to 2002 is negative \$225 ($-\$525 + \300).