



OFFICE OF
CHIEF COUNSEL

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
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INTERNAL REVENUE SERVICE NATIONAL OFFICE FIELD SERVICE ADVICE

MEMORANDUM FOR
DISTRICT COUNSEL

FROM: DEBORAH A. BUTLER
Assistant Chief Counsel CC:DOM:FS

SUBJECT: Asset Removal Costs

This Field Service Advice responds to your memorandum dated March 3, 2000. 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

A =

ISSUE

Whether the cost of removal of asbestos incident to the repair of production plants and machinery is deductible as a current expense or should be capitalized under I.R.C. section 263.

CONCLUSION

The cost of removal of asbestos incident to the repair of production plants and machinery is not deductible as a current expense and must be capitalized under I.R.C. section 263.

FACTS

A is an electric utility. It owns and routinely inspects and repairs production plants and machinery. As part of the inspection and repair of its production plants and machinery, A often is required to remove asbestos insulation. A maintains that it is entitled to deduct the cost of removing asbestos currently.

LAW AND ANALYSIS

Section 162 of the Internal Revenue Code and section 1.162-1 of the Income Tax Regulations generally allow a deduction for all the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business.

Section 165 allows as a deduction any loss sustained during the taxable year and not compensated for by insurance or otherwise. For the allowance under section 165(a) of losses arising from the permanent withdrawal of depreciable property from use in a trade or business or in the production of income, section 1.165-2(c) cross references section 1.167(a)-8(a), which permits, in part, a loss from physical abandonment of retired property.

Under sections 263(a) and 1.263(a)-1(a), no deduction is allowed for capital expenditures, such as amounts paid for new buildings or for permanent improvements or betterments made to increase the value of any property. Section 1.263(a)-2(a) provides that capital expenditures include the costs of acquisition, construction, or erection of buildings, machinery and equipment, furniture and fixtures, and similar property having a useful life substantially beyond the taxable year.

Section 263A generally requires taxpayers that are producing real or tangible personal property to capitalize direct material costs, direct labor costs, and indirect costs that are properly allocable to the produced property. Section 263A(g)(1) provides that, for purposes of section 263A, the term "produce" includes construct, build, install, manufacture, develop, or improve. Under section 1.263A-1(e)(3)(i), indirect costs are allocable to produced property under section 263A when the costs directly benefit or are incurred by reason of the performance of production activities.

Revenue Ruling 2000-7, 2000-9 I.R.B. 712, holds that if the retirement and removal of a depreciable asset occurs in connection with the installation or production of a replacement asset, the costs incurred in removing the retired asset are not required to be capitalized under section 263(a) or 263A as part of the cost of the replacement asset.

It is our understanding that A does not treat the asbestos insulation as a separate depreciable asset. Instead, it is a part of the individual production plant or machinery with which it is associated and is part of the capitalized cost of those assets. Therefore, the removal of the asbestos to inspect or repair production plants or machinery is not deductible as a current expense under Rev. Rul. 2000-7.

Please call if you have any further questions.

DEBORAH A. BUTLER
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By: _____
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