



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

OFFICE OF  
CHIEF COUNSEL

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FREV-249604-96

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 =

Utility =

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 relating to its gas utility distribution facilities 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 was a utility involved in the distribution of natural gas. Subsequent to the filing of the Form 3115, Taxpayer merged into Utility. Taxpayer, previously included certain items of property in asset class 49.21, Gas Utility Distribution Facilities, under Rev. Proc. 83-35, 1983-1 C. B. 745. Taxpayer believes that these items of property were erroneously depreciated under the depreciation system of former § 168. However, Taxpayer's proposed method to depreciate these items of property is also erroneous.

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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 15-year public utility property means public utility property (other than § 1250 class property or 3-year property) with a present class life of more than 25 years.

The term "class life" is defined in former § 168(g)(2) as meaning the class life (if any) that would be applicable with respect to any property as of January 1, 1981, under § 167(m) (determined without regard to § 167(m)(4) and as if the taxpayer had made an election under § 167(m)). 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 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.

Under the depreciation system of former § 168, pursuant to former § 168(b)(1), 15-year public utility property generally is depreciated by using a 15-year recovery period and the applicable percentage table in lieu of a particular depreciation method and convention. Under § 168(b)(3), however, a taxpayer could elect to use a longer recovery period, the straight line method of accounting, and the half-year convention.

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Taxpayer's business activity is described in gas utility asset class 49.21 of Rev. Proc. 83-35. Taxpayer does not represent that any elections were made for the property subject to the Form 3115. Accordingly, Taxpayer's proposed method of accounting uses erroneous recovery periods, depreciation methods, and conventions to depreciate the property.

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.

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