Internal Revenue Service

Department of the Treasury
Washington, DC 20224

Number: **200947033**
Release Date: 11/20/2009

Index Number: 263A.00-00, 263A.03-02, 263A.04-05, 381.05-04

Third Party Communication: None
Date of Communication: Not Applicable
Person To Contact:
, ID No.
Telephone Number:

Refer Reply To:
CC:ITA:B06
PLR-133667-09
Date:
August 20, 2009

Attention:

Parent =
S =
Date 1 =
Date 2 =
Predecessor =

Dear :

Parent's authorized representative is requesting a ruling under § 1.381(c)(5)-1(d)(1)(i) of the Income Tax Regulations on behalf of S, one of Parent's subsidiaries. S is requesting the Commissioner's consent to change to a method other than the principal method of accounting. Specifically, S is requesting consent to change its method of allocating and accounting for costs under § 263A of the Internal Revenue Code and the regulations thereunder, for the taxable year beginning Date 1 and ending Date 2. S uses an overall accrual method of accounting.

Prior to Date 1, S owned 100 percent of Predecessor's stock. On Date 1, Predecessor and S entered into a transaction to which § 381(a) applies. On Date 1, the fair market value of the inventory held by Predecessor was greater than the fair market value of inventory held by S, requiring S to use Predecessor's methods of allocating and accounting for costs under § 263A. *See* § 1.381(c)(5)-1(c)(2). S will use the principal method to capitalize the purchase price of raw materials, third-party processing charges and certain handling charges to ending inventory (section 471 costs). S will also use the principal method to allocate additional § 263A costs to ending inventory. However, S is not permitted to continue to use all of Predecessor's methods of allocating and accounting for costs under § 263A, because some of those methods do not clearly

reflect S's income. *See* § 1.381(c)(5)-1(c)(1)(i). Accordingly, S has requested a private letter ruling under § 1.381(c)(5)-1(d)(1)(i) to use another method.

S requests that the Commissioner allow it to allocate indirect costs that are not defined as section 471 costs to ending inventory by treating the capitalizable portion of the costs as additional § 263A costs under the simplified production method. S also requests that it be allowed to use the *de minimis* rule described in § 1.263A-1(g)(4)(ii) to determine if any portion or all of a mixed service department's costs are allocable to property produced. Additionally, S requests that it be allowed to use a facts and circumstances method to determine capitalizable mixed service costs for those mixed service departments that are not treated as engaged exclusively in production or non-production activities under the *de minimis* rule (because 90 percent or more of the department's costs are not capitalizable service costs or deductible service costs). *See* § 1.263A-1(g)(4)(i). Under this method, S states that it will allocate service costs to particular departments or activities based on a factor or relationship that reasonably relates the service cost to the benefits received from the service departments or activities.

Section 1.263A-1(g)(4)(i) provides, in relevant part, that, using reasonable factors or relationships, a taxpayer must allocate mixed service costs using a direct reallocation method, a step-allocation method, or any other reasonable allocation method (as defined under the principles of § 1.263A-1(f)(4)).

Section 1.263A-1(f)(4) provides, in relevant part, that an allocation method is reasonable if, with respect to the taxpayer's production activities taken as a whole, (i) the total costs actually capitalized during the taxable year do not differ significantly from the aggregate costs that would be properly capitalized using another permissible method described in §1.263A-1(f), with appropriate consideration given to the volume and value of the taxpayer's production activities, the availability of costing information, the time and cost of using various allocation methods, and the accuracy of the allocation method chosen as compared with other allocation methods; (ii) the allocation method is applied consistently by the taxpayer; and (iii) the allocation method is not used to circumvent the requirements of the simplified methods in §§ 1.263A-1, 1.263A-2, 1.263A-3, or the principles of § 263A.

Section § 1.263A-1(g)(4)(ii) provides that if 90 percent or more of a mixed service department's costs are service costs that do not directly benefit or are not incurred by reason of the performance of production or resale activities (deductible service costs), the taxpayer will not allocate any portion of the service department's costs to property produced and property acquired for resale during the taxable year. If 90 percent or more of a mixed service department's costs are service costs that directly benefit or are incurred by reason of the performance of production or resale activities (capitalizable service costs), the taxpayer will allocate 100 percent of the department's costs to the property produced and property acquired for resale during the taxable year. The

taxpayer will use reasonable factors or relationships to determine whether 90 percent or more of a mixed service department's costs are deductible service costs or capitalizable service costs.

The Commissioner has determined that the appropriate method for S to use for allocating and accounting for costs under § 263A is the method that S requested. Accordingly, the Commissioner under § 1.381(c)(5)-1(d)(1)(i) grants S consent to allocate indirect costs that are not defined as section 471 costs to ending inventory by treating the capitalizable portion of the costs as additional § 263A costs under the simplified production method; to use the *de minimis* rule described in § 1.263A-1(g)(4)(ii) to determine if any portion or all of a mixed service department's costs are allocable to property produced; and to use a facts and circumstances method to determine capitalizable mixed service costs.

Pursuant to § 1.381(c)(5)-1(e)(4), S will compute the adjustment necessary to reflect the change in the method of allocating and accounting for § 263A costs. S will take the adjustment into account in computing taxable income in the taxable year that includes Date 1.

Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter. We express no opinion regarding any determinations as to what constitutes a department, nor do we express an opinion regarding the propriety of the factors or relationships used to allocate indirect costs to the departments. We express no opinion as to whether specific departments and their associated costs are capitalizable, mixed service, or deductible departments or costs. We express no opinion regarding the propriety of the factors or relationships used to determine whether 90 percent or more of a mixed service department’s costs are deductible service costs or capitalizable service costs under the *de minimis* rule described in § 1.263A-1(g)(4)(ii). S’s use of a reasonable allocation method for determining its capitalizable mixed service costs is based on the assumption that the total costs actually capitalized during the taxable year under the new method will not differ significantly from the aggregate costs that would properly be capitalized using the methods of accounting for mixed service costs described in the regulations. *See* § 1.263A-1(g)(4)(i). We express no opinion regarding the propriety of S's method of allocating mixed service costs between production and non-production activities using a reasonable allocation method under § 1.263A-1(g)(4)(i). We also express no opinion regarding the propriety of S's method used to allocate section 471 costs to property produced during the taxable year. Additionally, we express no opinion as to whether § 381 applies, that the methods used by Predecessor on Date 1 were the principal methods of accounting under § 1.381(c)(5)-1(c)(2), and that the methods for allocating and accounting for costs failed to clearly reflect S’s income after Date 1. These determinations are to be made by the operating division director in connection with the examination of Parent's federal income tax returns.

This ruling is directed only to the taxpayer requesting it. Section 6110(k)(3) provides that it may not be used or cited as precedent.

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to Parent's authorized representatives.

A copy of this letter must be attached to any income tax return to which it is relevant. Alternatively, taxpayers filing their returns electronically may satisfy this requirement by attaching a statement to their return that provides the date and control number of the letter ruling.

The rulings contained in this letter are based upon information and representations submitted by Parent and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the material submitted in support of the request for rulings, it is subject to verification on examination.

Sincerely,

Roy A. Hirschhorn
Senior Technician Reviewer, Branch 6
(Income Tax & Accounting)

cc: