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subject: Definition of Inherently Permanent Structures under § 1.263A-8(c)(3)

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ISSUE

When does an outdoor advertising display constitute an inherently permanent structure pursuant to § 1.263A-8(c)(3) of the Income Tax Regulations and therefore qualify as real property for purposes of the domestic production activities deduction under § 199 of the Internal Revenue Code?

GENERIC FACT PATTERN

Company constructs and maintains outdoor advertising displays (billboards) and rents advertising space on the billboards to customers. Company's outdoor advertising displays consist of truckside billboards (mobile billboards), billboards mounted on wooden structures embedded in the ground (traditional billboards), and billboards mounted onto steel poles bolted or welded to a foundation (modern billboards).

Company is frequently required to obtain building permits or other licenses from governmental agencies before constructing traditional and modern billboards. Company's traditional and modern billboards are designed to withstand severe weather and require the use of construction machinery and equipment to install or remove.

The traditional and modern billboards are installed on leased land, and Company's land leases range from durations of 30 days to 20 years. The 30-day leases provide for 30-day period automatic renewals unless terminated by written notice from either party. Other leases do not explicitly provide for automatic renewal. All lease agreements require Company to remove the traditional and modern billboards at the expiration of each lease. It is the practice of Company, as well as Company's industry, to continue land leases until the billboards subject to the leases are no longer profitable. Accordingly, 95 percent of Company's traditional and modern billboards have remained on the same parcels of land since their initial construction. Unlike the traditional and modern billboards, however, Company relocates its mobile billboards on a frequent basis, often weekly, to locations that are best suited to meeting a particular client's advertising objectives.

Situation 1.

Mobile Billboard consists of 2 advertising display faces attached to the side of an operable truck. The display faces attached to the truck are approximately 12 feet high by 25 feet wide. Company moves Mobile Billboard to a different location 2 to 4 times monthly based on an advertising agreement with Customer.

Situation 2.

Traditional Billboard consists of an advertising display face nailed to a wooden support frame that is attached to one wooden pole 12 feet in length. The display face, made of exterior grade plywood sheets, is 5 feet high by 11 feet wide. The wooden pole is set 3 feet into the ground and secured in place by a ring of concrete 2 inches deep. Traditional Billboard is installed using construction machinery and equipment.

Company entered into a land lease for a 30-day term to install Traditional Billboard on Landlord's real property. The lease automatically renews every 30 days unless either party cancels in writing. The lease has automatically renewed for the last 10 years. Company is required to remove Traditional Billboard at the termination of the 30-day lease or any subsequent renewal.

Situation 3.

Modern Billboard consists of an advertising display face mounted to a steel frame that is attached to 4 structural steel poles. The steel poles are mounted to a 14-foot deep concrete and steel foundation. The display face, made of metal, is 20 feet high by 50 feet wide. Company obtains a building permit before constructing Modern Billboard, which is designed to remain anchored during severe weather conditions. Modern Billboard is periodically subject to an inspection process to ensure structural integrity. Modern Billboard is installed using construction machinery and equipment. Company

entered into a land lease for a 3-year term to install Modern Billboard on Landlord's real property. The lease contains an early release clause.

LAW AND ANALYSIS

Under § 199(a), the § 199 deduction is determined by applying a percentage to the lesser of the taxpayer's qualified production activities income (QPAI) or taxable income (determined without regard to the § 199 deduction). The applicable percentage is 3 percent for taxable years beginning in 2005 and 2006, 6 percent for taxable years beginning in 2007 through 2009, and 9 percent for taxable years beginning after 2009.

Under § 199(c)(1), QPAI is determined by taking domestic production gross receipts (DPGR) for the taxable year less cost of goods sold (CGS) allocable to such DPGR, less other expenses, losses, or deductions, which are properly allocable to such DPGR.

Section 199(c)(4)(A)(i)(I) provides the term DPGR means the gross receipts of the taxpayer which are derived from any lease, rental, license, sale, exchange, or other disposition of qualifying production property (QPP) which was manufactured, produced, grown, or extracted by the taxpayer in whole or in significant part within the United States.

Section 199(c)(5)(A) defines QPP as including tangible personal property. Section 1.199-3(j)(2)(i) defines the term "tangible personal property" as any tangible property other than land, real property described in § 1.199-3(m)(3). Section 1.199-3(m)(3) defines real property to mean buildings (items that are structural components of buildings), inherently permanent structures (as defined in § 1.263A-8(c)(3)) other than machinery (as defined in § 1.263A-8(c)(4)) (including items that are structural components of inherently permanent structures), inherently permanent land improvements, oil and gas wells, and infrastructure.

Real property defined in § 1.263A-8(c)(1) includes land, unsevered natural products of land, buildings, and inherently permanent structures. The term "inherently permanent structure" (IPS) is defined in § 1.263A-8(c)(3) to include property that is affixed to real property and that will ordinarily remain affixed for an indefinite period of time. As the words "inherently permanent" suggest, the essential character of an inherently permanent structure is that the property requires attachment to real property to be able to perform its intended function for a duration of time not initially known. Thus, this definition establishes two basic criteria for an IPS: first, it is affixed to real property; second, it will ordinarily remain affixed for an indefinite period of time.¹

The IPS definition is illustrated by numerous examples, including swimming pools, roads, bridges, tunnels, paved parking areas and other pavements, special foundations,

¹ Section 1.263A-8(c)(3) also provides that any property not otherwise described in § 1.263A-8(c)(3) that constitutes other tangible property under the principles of former § 48(a)(1)(B) and § 1.48-1(d) is treated for the purposes of § 1.263A-8(c)(3) as an inherently permanent structure.

wharves and docks, fences, inherently permanent advertising displays, inherently permanent outdoor lighting facilities, railroad tracks and signals, telephone poles, power generation and transmission facilities, permanently installed telecommunications cables, broadcasting towers, oil and gas pipelines, derricks and storage equipment, grain storage bins and silos.

Section 1.263A-8(c)(3) uses the term “affixed to real property” for its ordinary and common sense meaning, that is, physically connected or attached. Affixation to real property may be accomplished by weight alone. Section 1.263A-8(c)(3). Embedding a structure in the ground can establish attachment to real property. In addition, mounting a structure to a foundation can accomplish adequate connection to real property. Similarly, affixation may be achieved when the means of connection secure a structure to real property to withstand severe weather conditions. If installation of the structure involves the use of construction machinery and equipment, attachment to real property may be indicated.

For purposes of determining when a structure is physically attached to real property, it is irrelevant that the means of connection permit removal without damage to the structure. A structure attached by weight alone is likely removable without damage. Similarly, a structure bolted to a cement foundation that is embedded in the ground is likely removable without damage but nevertheless is connected to real property. However, the manner of affixation should sufficiently secure the structure so that it will remain in place to be able to perform its intended function.

An IPS will ordinarily remain affixed to real property for an indefinite period of time. The term “ordinarily remain affixed for an indefinite period of time” under § 1.263A-8(c)(3) means that the structure will typically remain affixed to real property for the period during which the structure is expected to be maintained to remain in operating condition and serve a useful function, that is, the useful life inherent in the structure. A structure that has to be connected to real property to be able to provide utility or to be able to perform its intended function is a structure that will ordinarily remain affixed to real property for an indefinite period of time. Thus, in general, the structure is attached without any fixed plan to remove it at a particular date in the future, and the exact date when a structure will be removed is neither known nor knowable when it is affixed.

The term “ordinarily remain affixed for an indefinite period of time” recognizes that even an inherently permanent structure may become disconnected from real property. The term “ordinarily” requires that, usually or in most cases, the structure will remain attached to real property but recognizes that a structure may become detached from real property for various reasons. For example, a structure may become dismantled from real property by hurricane force winds or intentionally detached by construction machinery or equipment should the structure need to be repaired, moved to another location, or disposed of. The possibility or occurrence of temporary or permanent removal from real property does not transform the intrinsically permanent nature of a structure.

Practices of an industry or taxpayer also may be instructive as to whether a particular structure or type of structure is likely to stay connected to real property for the useful life inherent in the structure. For example, a structure that must be attached to land to be functional may remain connected to real property for an indefinite period of time, even when the lease term is definite and the removal of the structure is required at the expiration of the lease. In that case, industry or taxpayer practice will likely be to renew the land lease until the structure's inherent useful life is exhausted or the structure is no longer profitable. Also for consideration is how much time and expense are involved in affixing the structure to be able to function. If a taxpayer makes the decision to expend significant resources to affix a structure to real property to be able to perform its intended function, it likely demonstrates the inherent permanency of the structure.

A structure, though, does not exist in perpetuity. To the contrary, it deteriorates or becomes obsolete over time. Accordingly, "remain affixed for an indefinite period of time" cannot sensibly be interpreted to require that the structure remain attached to real property forever because virtually no property would satisfy that definition, including most, if not all, of the examples in § 1.263A-8(c)(3).

CONCLUSION

While a determination is made based on the totality of the circumstances in each case, an outdoor advertising display is an inherently permanent structure under § 1.263A-8(c)(3) and is therefore real property for purposes of the domestic production activities deduction under § 199 when it is attached to real property and will ordinarily remain connected to real property to be able to perform its intended function.

Situation 1.

Mobile Billboard is not an inherently permanent structure under § 1.263A-8(c)(3). Mobile Billboard is not attached to real property, nor is it intended to remain stationary indefinitely to be able to perform its intended function, advertising. Rather, Mobile Billboard is a truck with advertising faces attached and is intended to be moved frequently. See TAM 200101003 (noting a mobile billboard mounted on wheels and held in place with ropes and stakes would not be an inherently permanent structure for purposes of § 1.263A-8(c)(3)).²

Situation 2.

Traditional Billboard is an inherently permanent structure under § 1.263A-8(c)(3). Traditional Billboard is an inherently permanent advertising display similar in nature to the example of a telephone pole, an IPS generally constructed with a wooden pole, in

² Mobile Billboard is also not other tangible property for purposes of former § 48(a)(1)(B) and § 1.48-1(d).

§ 1.263A-8(c)(3). Traditional Billboard is connected to real property because a wooden pole 12 feet in length is set in the ground and secured in place by concrete. Attachment to real property is also indicated by the use of construction machinery and equipment to install Traditional Billboard. Traditional Billboard was constructed to stay connected to real property to be able to perform its intended function, advertising. Thus, Traditional Billboard will ordinarily remain in place for an indefinite period of time.

It is irrelevant for this determination that Traditional Billboard was constructed on Landlord's property under an initial 30-day lease or that the lease automatically renews every 30 days until either party cancels. These lease terms, if anything, suggest that the actual duration of the lease is not known when the parties entered into the lease; here, the 30-day lease has been renewed for 10 years. Regardless, the stated lease duration known before the construction of Traditional Billboard, the automatic renewal provision in the lease, or the actual duration known at the final expiration of the lease does not change the essential character of the inherently permanent structure. The intrinsic permanency of a structure is not determined in hindsight. The provision requiring removal at the end of the lease also does not alter the inherently permanent nature of the Traditional Billboard's structure. There is no requirement that a structure be installed with the intention of being permanently attached to real property nor must the structure literally remain connected forever to be an inherently permanent structure.

Situation 3.

Modern Billboard is an inherently permanent structure under § 1.263A-8(c)(3). Modern Billboard is an inherently permanent advertising display similar in nature to the example of a broadcasting tower in § 1.263A-8(c)(3), an IPS typically bolted to either a foundation buried in the ground or to a building. Modern Billboard is attached to real property because 4 steel poles are mounted to a 14-foot deep concrete and steel foundation.³ In addition, Modern Billboard required a building permit, was installed with construction machinery and equipment, was engineered to withstand severe weather conditions, and is periodically inspected for structural integrity. Considering the expense and time involved with obtaining designs with appropriate specifications and building permits, installation, and the process of periodic inspections, these facts indicate that the intrinsic nature of Modern Billboard is of a permanence required by § 1.263A-8(c)(3). Modern Billboard was constructed to stay connected to real property to be able to perform its intended function, advertising. Thus, Modern Billboard will ordinarily remain in place for an indefinite period of time.

It is irrelevant for this determination that Modern Billboard was constructed on Landlord's property under a 3-year lease with a provision for early termination. The stated lease duration or the possibility that the lease may be terminated early or

³ The foundation and the advertising display are viewed here as components of one unit of property for purposes of § 1.263A-10. Regardless, the foundation is real property under § 1.263A-8(c)(3) because it will ordinarily remain affixed for an indefinite period of time.

renewed does not fix in time the actual duration of Modern Billboard's attachment to real property nor change the intrinsic character of the inherently permanent structure.

CASE DEVELOPMENT, HAZARDS AND OTHER CONSIDERATIONS

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