Internal Revenue Service

Number: **201410029**
Release Date: 3/7/2014

Index Number: 446.04-13

Department of the Treasury
Washington, DC 20224

Third Party Communication: None
Date of Communication: Not Applicable

Person To Contact:
, ID No.
Telephone Number:

Refer Reply To:
CC:ITA:B07
PLR-139460-12

Date:
March 13, 2013

Taxpayer	=	
State1	=	
A	=	
B	=	
C	=	
D	=	
Date1	=	
Date2	=	
Date3	=	
Date4	=	

Dear :

This letter responds to a letter dated Date1, and supplemental information provided on Date2, submitted by Taxpayer requesting a letter ruling under § 446 of the Internal Revenue Code on whether a change in computing depreciation for purposes of computing earnings and profits (E&P) of Taxpayer is a change in method of accounting under §§ 446(e) and 481(a).

FACTS

Taxpayer is a domestic subchapter C corporation, incorporated in State1, engaged in the A business and also is the common parent of an affiliated group of corporations filing a consolidated Federal income tax return. It provides certain core and related services in connection with its A business for B and C. Taxpayer plans to make a REIT election for Federal income tax purposes under §§ 856-859 beginning with the taxable year ending Date3.

Taxpayer uses D in its trade or business. On Date4, Taxpayer filed a Form 3115, *Application for Change in Accounting Method*, to change its method of accounting for depreciation for D for Federal income tax purposes. Under Taxpayer's current method of accounting for Federal income tax purposes, Taxpayer classified the D placed in service after 1986 as 5-year property under § 168(e)(1), depreciating it under the general depreciation system of § 168(a) (GDS). For E&P purposes, Taxpayer depreciated the D placed in service after 1986 under the alternative depreciation system of § 168(g) (ADS) using a 9-year recovery period.

Further, for Federal income tax purposes, Taxpayer classified and depreciated the D placed in service after 1980 and before 1987 as 5-year property under § 168 as in effect on the day before the enactment of the Tax Reform Act of 1986 (ACRS). For E&P purposes, Taxpayer depreciated the D placed in service after 1980 and before 1987 using a 12-year recovery period in accordance with § 312(k)(3)(A) as in effect on the day before the enactment of the Tax Reform Act of 1986 (former § 312(k)(3)(A)).

Under Taxpayer's proposed method of accounting for Federal income tax purposes, Taxpayer will classify the D placed in service after 1986 as nonresidential real property under § 168(e)(2), depreciating it under the GDS, using the straight-line method of depreciation, the mid-month convention, and a 39-year recovery period. Section 168(b)(3)(A), (c), and (d)(2)(A). Under § 312(k)(3)(A), in computing its E&P, Taxpayer is required to depreciate its nonresidential real property placed in service after 1986 under the ADS, using the straight-line method of depreciation, the mid-month convention, and a 40-year recovery period.

For Federal income tax purposes, Taxpayer also proposes to classify and depreciate the D placed in service after 1980 and before 1987 as 15-year real property, 18-year real property, or 19-year real property, as applicable, under ACRS. Under former § 312(k)(3)(A), in computing its E&P, Taxpayer is required to depreciate the 15-year real property, 18-year real property, or 19-year real property using a 40-year recovery period (for D placed in service after 1984 and before 1987) or a 35-year recovery period (for D placed in service after 1980 and before 1985).

RULINGS REQUESTED

1) A change in computing depreciation for E&P purposes under § 312(k) is a change in method of accounting under §§ 446 and 481(a); accordingly, Taxpayer must request the consent of the Secretary to change its method of computing depreciation for E&P purposes and, in computing E&P, shall take a § 481(a) adjustment into account over the same adjustment period as is required for changes in depreciation methods for Federal income tax purposes.

2) Alternatively, if the change in computing depreciation for E&P purposes under § 312(k) is not a change in method of accounting under §§ 446 and 481(a),

Taxpayer can implement the change in computing depreciation for E&P purposes in the manner provided in § 1.446-1(e)(2)(ii)(*d*)(*5*)(*iv*) or (*v*) of the Income Tax Regulations. Specifically, Taxpayer may correct the depreciation used for E&P purposes by taking the adjusted basis of the property at the beginning of the taxable year of change and use the proper depreciation method, convention, and recovery period to compute depreciation over the remaining recovery period.

LAW AND ANALYSIS

Section 446(a) generally provides that taxable income shall be computed under a method of accounting on the basis of which the taxpayer regularly computes income in keeping its books. Section 1.446-1(e)(1) provides that a taxpayer filing its first return may adopt any permissible method of accounting in computing taxable income for the taxable year covered by such return.

Section 446(e) generally provides that a taxpayer who changes the method of accounting on the basis of which the taxpayer regularly computes the taxpayer's income in keeping the taxpayer's books shall, before computing the taxpayer's taxable income under the new method, secure the consent of the Secretary. Section 1.446-1(e)(2)(i) provides that a taxpayer who changes the method of accounting employed in keeping the taxpayer's books shall, before computing the taxpayer's income upon such new method for purposes of taxation, secure the consent of the Commissioner.

A change in method of accounting includes a change in the overall plan of accounting for gross income or deductions or a change in the treatment of any material item used in such overall plan. A material item is any item that involved the proper time for the inclusion of the item in income or the taking of a deduction. Section 1.446-1(e)(2)(ii)(*a*).

In determining whether a taxpayer's accounting practice for an item involves timing, generally the relevant question is whether the practice permanently changes the amount of a taxpayer's lifetime taxable income. If the practice does not permanently affect the taxpayer's lifetime taxable income but does or could change the taxable year in which income is reported, it involves timing and is therefore a method of accounting. See Rev. Proc. 91-31, 1991-1 C.B. 566, Rev. Proc. 2011-14, 2011-4 I.R.B. 330.

A change in method of accounting does not include correction of mathematical or posting errors, or errors in the computation of tax liability (such as errors in the computation of the foreign tax credit, net operating loss, percentage depletion, or investment credit). Also, a change in method of accounting does not include adjustment of any item of income or deduction that does not involve the proper time for the inclusion of the item of income or the taking of a deduction. Section 1.446-1(e)(2)(ii)(*b*).

A change in the period of recovery, a change in the convention, or a change in the depreciation method of a depreciable asset is a change in method of accounting under § 446(e). See 1.446-1(e)(2)(ii)(*d*)(*2*)*(i).*

Section 481(a) provides that in computing the taxpayer's taxable income for the taxable year (year of change) (1) if such computation is under a method of accounting different from the method under which the taxpayer's taxable income for the preceding taxable year was computed, then (2) there shall be taken into account those adjustments which are determined to be necessary solely by reason of the change in order to prevent amounts from being duplicated or omitted, except there shall not be taken into account any adjustment in respect of any taxable year to which this section does not apply unless the adjustment is attributable to a change in method of accounting initiated by the taxpayer.

Rev. Proc. 2011-14, 2011-4 I.R.B. 330, as modified by Rev. Proc. 2012-39, 2012-41 I.R.B. 470, (automatic consent procedures) and Rev. Proc. 97-27, 1997-1 C.B. 680, as amplified and modified by Rev. Proc. 2002-19, 2002-1 C.B. 696, as amplified and clarified by Rev. Proc. 2002-54, 2002-2 C.B. 432, as modified by Rev. Proc. 2007-67, 2007-2 C.B. 1072, as modified by Rev. Proc. 2009-39, 2009-38 I.R.B. 371, as modified by Rev. Proc. 2011-14 and as modified by Rev. Proc. 2012-39, (advance consent procedures) provide the administrative procedures to request consent to change a method of accounting under § 446(e). Rev. Proc. 2011-14 is the exclusive procedure to request a change in method of accounting that is expressly described in its Appendix.

Section 312(a) generally provides that on the distribution of property by a corporation with respect to its stock, the E&P of the corporation (to the extent thereof) shall be decreased by the sum of: (1) the amount of money, (2) the principal amount of the obligations of such corporation (or, in the case of obligations having original issue discount, the aggregate price of such obligations), and (3) the adjusted basis of the other property, so distributed.

Section 1.312-6 provides that due consideration must be given to the facts, and while mere bookkeeping entries increasing or decreasing surplus will not be conclusive, the amount of the E&P in any case will be dependent on the method of accounting properly employed in computing taxable income (or net income, as the case may be). For instance, a corporation keeping its books and filing its income tax returns on the cash receipts and disbursements basis may not use the accrual basis in determining E&P.

Section 312(k)(1) generally provides that for purposes of computing E&P of a corporation, the allowance for depreciation shall be determined using the straight-line method of depreciation. Section 312(k)(3) generally provides that, in the case of tangible property to which § 168 applies, the adjustment to E&P for depreciation for any

taxable year shall be determined under the ADS. Therefore, in the computation of E&P, the recovery period for nonresidential real property is 40 years. Sections 168(g)(2)(C)(iii) and 312(k)(3).

Former § 312(k)(3)(A) generally provided that, in the case of recovery property (within the meaning of ACRS), the adjustment to E&P for depreciation for any taxable year shall be the amount determined using the straight-line method (using a half year convention in the case of property other than 15-year real property, 18-year real property, or 19-year property, and without regard to salvage value) and using a recovery period determined in accordance with the table under former § 312(k)(3)(A). Therefore, in the computation of E&P, the recovery period is 40 years generally for real property placed in service after 1984 and before 1987 and is 35 years generally for real property placed in service after 1980 and before 1985. Former § 312(k)(3)(A).

Rev. Proc. 79-47, 1979-2 C.B. 528, provides the procedures outlining the effect on E&P resulting from an adjustment required by § 481(a) for a change in method of accounting for taxable income purposes under § 446(e). In order to prevent distortions, when computing E&P (current and accumulated) available for the payment of dividends, the taxpayer shall follow its new method for reporting taxable income and shall take the applicable § 481(a) adjustment into account over the same period as it does for purposes of computing taxable income.

Issue 1

For property subject to § 168 (or ACRS), the depreciation deduction for taxable income is not the same for E&P purposes. Taxpayer is changing its method of computing depreciation for taxable income and E&P purposes. Taxpayer's first requested ruling is whether a change in computing depreciation for E&P purposes under § 312(k) (or former § 312(k)(3)) is a change in method of accounting under §§ 446(e) and 481(a) such that consent of the Secretary is required to make that change, separate and apart from the consent required to change its method of computing depreciation for taxable income purposes.

In the instant case, Taxpayer filed a Form 3115 on Date4, under Rev. Proc. 2011-14 to change its method of computing depreciation for D for taxable income purposes. The changes in Taxpayer's depreciation method, recovery period from a 5-year recovery period to a 39-year recovery period, and convention for D for taxable income purposes are changes in methods of accounting under §§ 446(e) and 481(a). See § 1.446-1(e)(2)(ii)(*d*)(*2*)*(i)* (changes in depreciation method, convention and recovery period to compute taxable income are changes in methods of accounting under § 446(e)).

When Taxpayer changed its method of accounting for depreciation for D for taxable income purposes, a correlative change to Taxpayer's method of computing

depreciation for E&P purposes for D was required. Section 312(k)(3) and § 1.312-6 (*see also* former § 312(k)(3)). Accordingly, here, when Taxpayer changed its method of accounting for depreciation for taxable income purposes, no additional consent is required for Taxpayer to make the required correlative change in computing its depreciation for E&P purposes.

Rev. Proc. 79-47 recognizes that the § 481(a) adjustment resulting from a change in method of accounting for taxable income purposes may create a distortion in E&P available for distribution in the year of change, and provides that the required § 481(a) adjustment for taxable income purposes shall be spread, for E&P purposes, over the same adjustment period as that used for taxable income purposes. However, as stated above, § 312(k)(3) (and former § 312(k)(3)) requires Taxpayer to use a different method of computing depreciation for D for E&P purposes than is permitted for taxable income purposes. As such, additional adjustments to E&P under § 312 and the accompanying regulations are necessary to correctly compute Taxpayer's current and accumulated E&P to comply with § 312(k)(3) (and former § 312(k)(3)).

Issue 2

If the change in computing depreciation for E&P purposes under § 312(k) is not a change in method of accounting requiring additional consent under §§ 446(e) and 481(a), Taxpayer requests a ruling that it may implement its change in computing depreciation for E&P purposes by taking the adjusted basis of the property at the beginning of the taxable year of change for E&P purposes and use the proper depreciation method, convention, and recovery period for E&P purposes to compute depreciation for E&P purposes over the remaining recovery period.

Taxpayer's second requested ruling is consistent with § 1.446-1(e)(2)(ii)(*d*)(*5*)(*iv*) or (*v*). These regulation sections provide how a taxpayer corrects a change in the useful life, or a change in the placed-in-service date, of a depreciable asset for taxable income purposes. Neither change generally is a change in method of accounting under §§ 446(e) and 481(a). However, § 1.446-1(e)(2)(ii)(*d*)(*5*)(*iv*) or (*v*) does not provide guidance on how to change depreciation for E&P purposes.

In the instant case, Taxpayer is changing its method of accounting for depreciation of D for taxable income purposes under §§ 446(e) and 481(a), and shall take into account the required § 481(a) adjustment in computing taxable income. Taxpayer also is changing its depreciation of D for E&P purposes. In correcting this change in depreciation for E&P purposes, Taxpayer shall take into account the adjustment that must be made to its E&P due to the change in computing E&P for depreciation of D over the same period of time as Taxpayer does for the § 481(a) adjustment due to the change in method of accounting for depreciation of D for taxable income purposes under § 446(e).

CONCLUSIONS

Accordingly, based solely on the representations submitted by Taxpayer and the applicable law and analysis discussion above, we conclude that:

(1) A change in Taxpayer's method of accounting for depreciation of D for taxable income purposes under §§ 446(e) and 481(a) requires a correlative change in computing depreciation of D for E&P purposes under § 312(k)(3) (or former § 312(k)(3)). Accordingly, consent of the Secretary is not required to make that change for E&P purposes, separate and apart from the consent required to change its method of accounting for depreciation for taxable income purposes. Further, because the depreciation deduction for D for taxable income is not the same for E&P purposes, additional adjustments are required to account for the change in computing depreciation for E&P purposes, which are made under § 312 and the accompanying regulations.

(2) Because Taxpayer must take into account the § 481(a) adjustment arising from the change in method of accounting for depreciation for taxable income purposes over 4 years, Taxpayer, in computing E&P, shall take the correlative adjustments arising from the change in computing depreciation for E&P purposes over the same period of time as it takes into account such § 481(a) adjustment. See Rev. Proc. 79-47.

The rulings contained in this letter are based upon information and representations submitted by Taxpayer 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.

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 ruling. No opinion is expressed or implied as to whether the assets that are the subject of the letter ruling are nonresidential real property under § 168(e)(2)(B), or are 15-year real property, 18-year real property, or 19-year real property under ACRS. Further, no opinion is expressed or implied regarding the tax consequences of Taxpayer's proposed REIT conversion on the § 481(a) adjustment period or E&P adjustments at the time of the REIT conversion.

This letter ruling is directed only to Taxpayer. 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, we are sending a copy of this letter ruling to Taxpayer's authorized representatives. We also are sending a copy of this letter ruling to the appropriate operating division director.

Sincerely,

Kathleen Reed

Kathleen Reed
Branch Chief, Branch 7
Office of Associate Chief Counsel
(Income Tax & Accounting)

Enclosures (2):
copy of this letter
copy for section 6110 purposes