

Office of Chief Counsel
Internal Revenue Service

memorandum

CC:LM:NR:DAL:2OKL:TL-N-5003-00
CGMcLoughlin

date: APR 5 2001

to: Team 1601, Large and Mid-size Business Division,
Retailers, Food and Pharmaceuticals
Attn: Charles O. Stanphill,

from: Associate Area Counsel (LMSB:DAL:2), Oklahoma City P.O.D. 2000-OKC

subject: Request for Assistance - Pre-filing Agreement

Taxpayer: [REDACTED]
IN: [REDACTED]

We are responding to your request for assistance in reviewing a proposed pre-filing agreement with [REDACTED]. This memorandum should not be cited as precedent. The proposed pre-filing agreement attempts to classify certain expenditures incurred at [REDACTED]'s [REDACTED] either as capital expenditures or as repairs and replacements. In the proposed agreement, expenditures equal to or less than certain dollar thresholds, such as \$ [REDACTED] or \$ [REDACTED] are automatically classified as currently deductible repairs or maintenance. As such, the proposed agreement sets forth a de minimis standard for the capitalization of expenditures. Because the agreement attempts to establish a de minimis standard for classifying an expenditure as either a deductible repair or a capital expenditure, the pre-filing agreement is outside the scope of both Notice 2000-12, 2000-9 I.R.B. 727 (February 28, 2000) and Rev. Proc. 2001-22, 2001-9 I.R.B. 745 (February 26, 2001).

In describing pre-filing agreements, Section 1.02 of Rev. Proc. 2001-22 provides that the purpose of the revenue procedure is to facilitate and encourage the use of pre-filing examinations to resolve issues involving factual questions under well settled principles of law. The revenue procedure applies only to issues involving the application of well settled principles of law. Rev. Proc. 2001-22 is not intended to resolve issues involving questions of law that are not well settled with respect to the

material facts of the issue. Such issues are more appropriately resolved through the private letter ruling process. See § 1.03 of Rev. Proc. 2001-22; Rev. Proc. 2001-1, 2001-1 I.R.B. 1 (January 1, 2001).

Section 3.03 provides the areas in which the Service will enter into a pre-filing agreement. The Service generally will consider entering into an LMSB pre-filing agreement on any issue that represents either (i) a factual determination or (ii) an application of legal principles to agreed upon facts in which the legal principles are well established in their application to such facts. However, the Service will not consider entering into an LMSB pre-filing agreement with respect to (i) any international issue that is not listed in Section 3.05 of the revenue procedure, or (ii) any excluded issue listed in Section 3.06 of the revenue procedure.

Section 3.04 of Rev. Proc. 2001-22 provides a nonexclusive list of eligible domestic issues. This list includes the allocation of costs among different categories of deductible and capital items, in contexts where there is a published revenue ruling, e.g. repairs (Rev. Rul. 94-12, 1994-1 C.B. 36), advertising (Rev. Rul. 92-80, 1992-2 C.B. 57), and Y2K costs (Rev. Proc. 97-50, 1997-2 C.B. 525).

Section 3.06(3) of Rev. Proc. 2001-22 provides that the Service generally will not enter into an LMSB pre-filing agreement on issues that can be resolved by requesting a change in method of accounting on Form 3115, Application for Change in Accounting Method. Further, Section 3.07 of the revenue procedure clarifies that the LMSB pre-filing agreement's application of the law to the taxpayer's facts may result in treating an item differently from earlier treatments of similar items in prior taxable years (e.g., deducting items that previously were capitalized, such as certain ISO 9000 costs). If so, the differing treatment may constitute a change in the method of accounting for that item. The LMSB pre-filing agreement will resolve only the factual characterization of the items at issue for the taxable years to which the LMSB pre-filing agreement relates, but will not constitute the Commissioner's consent to make any accounting method change that may be required to conform the agreed upon factual characterization of the item with identical items in earlier years. Permission to make any accounting method changes required by the LMSB pre-filing agreement's resolution of the factual and legal issues must be obtained using the applicable administrative procedures. See Rev. Proc. 99-49, 1999-2 C.B. 725 (automatic consent to change certain accounting methods); Rev. Proc. 97-27, 1997-1 C.B. 680.

The proposed pre-filing agreement is not appropriate under Rev. Proc. 2001-22, since it covers an area of the law that is not settled. In fact, the agreement appears to be contrary to the Service's position regarding the de minimis rule. Further, if the de minimis rule were an area of settled law, the proposed pre-filing agreement involves a change in method of accounting that is more appropriately resolved through the filing of a Form 3115. These concerns are outlined below.


The use of a de minimis rule to characterize expenditures as deductible repairs or capital expenditures is not a settled area of the law. Although Rev Rul. 92-80 generally allows a deduction for repairs, it does not address dollar limits. While the Service once considered issuing a revenue ruling adopting a de minimis rule (GCM 34959), that revenue ruling was never issued. The Service has in the past litigated the use of a de minimis standard for capitalization purposes and is litigating this issue now. Consequently, the use of a de minimis rule is by no means an established principle of law.

Secondly, even if the de minimis rule were an area of settled law, the proposed pre-filing agreement involves a change in method of accounting. Such accounting method changes are more appropriately resolved through the filing of a Form 3115 rather than a pre-filing agreement. This type of method change currently is handled by filing a Form 3115 where issues involving the clear reflection of income can be examined. Thus, the proposed imposition of a de minimis rule for capitalization purposes should not be included in a pre-filing agreement.

Please contact Glenn McLoughlin at (405) 297-4803 if you have any questions. We are closing our file.

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MARK E. O'LEARY
Associate Area Counsel

By: 

C. GLENN McLOUGHLIN
Senior Attorney

cc: AAC (LMSB:DAL:2)