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CHIEF COUNSEL

DEPARTMENT OF THE TREASURY
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INTERNAL REVENUE SERVICE NATIONAL OFFICE FIELD SERVICE ADVICE

MEMORANDUM FOR JEFFREY P. EHRLICH
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FROM: DEBORAH A. BUTLER
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SUBJECT: Depreciation of Raised Floor Installed in an Office Building
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This Field Service Advice responds to your memorandum dated February 16, 2000. Field Service Advice is not binding on Examination or Appeals and is not a final case determination. This document is not to be cited as precedent.

LEGEND

Taxpayer
Tax Year
Amount-1

ISSUES

1. Whether a raised floor installed during the initial construction of an office building to facilitate the installation of computer systems is personal property under I.R.C. § 168 or a structural component of a building?
2. If the raised floor is personal property under I.R.C. § 168, what is the appropriate recovery period?
3. Should Rev. Rul. 74-391, 1974-2 C.B. 9 be reconsidered in light of changes in the business environment since its issuance?

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CONCLUSIONS

Issue 1: Based on the facts submitted, we believe the raised floor in this case would be considered personal property under Rev. Rul. 74-391. If additional fact finding reveals any additional information supporting a determination that it is a structural component of the building, this issue may be revisited.

Issue 2: The raised floor is appropriately classified in Asset Class 57.0 and has a 5-year recovery period.

Issue 3: There are no plans to revisit Rev. Rul. 74-391.

FACTS

TAXPAYER is in the business of providing various computer-related services to banks. During TAX YEAR, the taxpayers constructed and placed in service a AMOUNT-1 square foot data center which consists of a three story building. Two floors are devoted to offices and computer equipment and one floor is a parking garage.

The first floor of the building was constructed with a raised floor to facilitate the installation of wiring, plumbing, and ventilation for computers and other equipment. The raised floor includes removable panels that provide access to the space between the raised floor and the sub-floor. There is no finished floor below the raised floor. The raised floor is installed in most of the first floor of the building including a computer room, printer room, storage rooms, mail room, conference rooms, offices, customer service areas, mechanical and electrical rooms, and telecommunications rooms. The only areas without the raised floor are the main lobby, restrooms, stairwells, and the corridors connecting the stairwells to emergency exits.

The raised floor is installed in approximately 90 percent of the total square footage available on the floor. The interior spaces of the building are designed around the raised floor. Doors and ceilings are full height from the top of the floor. Walls reach from the top of the raised floor to the ceiling. Removal of the raised floor, while possible would necessitate a major renovation of the interior of the building.

The taxpayer identified the raised floor as personal property under I.R.C. § 1245. The taxpayer engaged an outside firm to conduct a "cost segregation study" in support of its position on the raised floor. The taxpayer claims that the raised floor is 5-year property for purposes of I.R.C. § 168.

LAW AND ANALYSIS

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Section 167(a) permits the taxpayer to take depreciation deductions for the exhaustion, wear and tear of property used in its trade or business, or of property held for the production of income. For tangible property placed in service after 1986, section 168 provides that the depreciation deduction is determined by using the applicable depreciation method, the applicable recovery period and the applicable convention.

The only issue here is the applicable recovery period. The mechanics of determining the applicable recovery period are somewhat complicated. First, recovery periods correspond to different classes of property (the depreciable asset). Section 168(c). Four of the classes bear somewhat descriptive titles, such as the class of "nonresidential real property" which had a recovery period of 31.5 years for the tax years at issue. However, the six remaining classes do not have descriptive titles, and are labeled only in number terms corresponding to their recovery periods: i.e. "three year property", "five year property", etc. These six classes are further described at section 168(e), which defines each of these classes in terms of the "class life" of the property belonging to it. Thus for example, if a depreciable asset has a class life of sixteen to twenty years, it is "10-year property" under section 168(e)(1), and has a recovery period of ten years under section 168(c). (A special recovery period is assigned to property with no class life.) Next, the term "class life" is defined by section 168(i)(1). That definition incorporates former section 167(m), which specifically authorized the Commissioner to promulgate regulations regarding class lives of depreciable assets.

The Commissioner did issue regulations, and two rules deriving from them are most pertinent here. First, property is to be classified according to its primary use, even though that use may be insubstantial in relation to all the taxpayer's other activities. Treas. Reg. section 1.167(a)-11(b)(4)(iii)(b). Second, while the regulations did not themselves set out class lives, they left it to the Commissioner to make those determinations in issued revenue procedures. Treas. Reg. section 1.167(a)-11(b)(ii). Thus, we come to Rev. Proc. 87-56, 1987-2 C.B. 674 (Rev. Proc. 87-56), the revenue procedure in effect for the years at issue.

Rev. Proc. 87-56 sets out the current class lives and recovery periods of property subject to section 168 of the Internal Revenue Code. It divides assets into two broad categories: (1) Asset guideline classes 00.11 through 00.4, consisting of specific depreciable assets used in all business activities (the asset category); and (2) asset guideline classes 01.1 through 80.0, consisting of depreciable assets used in specific business activities (the activity category). The same item of depreciable property can be described in both an asset category and an activity category. See for example Norwest Corporation & Subsidiaries v. Commissioner, 111 T.C. 105 (1998), where the court decided whether an item described in both an asset and an activity category (furniture and fixtures) should be placed in the

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activity category or the specific asset category. The court determined that the asset category took priority.

The taxpayer contends that the raised floor is properly classified as tangible personal property and should be considered 5-year recovery property. The examiner presumes the 5-year recovery period results from the taxpayer characterizing the raised floor as part of asset class 00.12 "Information Systems" as defined in Rev. Proc. 87-56. The examining agent believes the raised floor is a structural component of the building, nonresidential real property. The recovery period of nonresidential real property is established by statute.

Nonresidential real property is defined as section 1250 property which is not residential rental property or property with a class life of less than 27.5 years. Section 168(e)(2)(B). Section 168(i)(12) provides that section 1250 property has the same meaning as given in section 1250(c). Section 1250 property is any real property, other than section 1245 property, which is or has been of a character subject to the allowance for depreciation provided in section 167. Section 1250(c).

Section 1245 property is any property of a character subject to the allowance for depreciation under section 167 and is either (a) personal property, (b) other tangible property (not including a building or its structural components) used in connection with a qualified activity or a research or storage facility used with a qualified activity, (c) a single purpose agricultural or horticultural structure or, (d) a storage facility used in connection with the distribution of petroleum). Section 1245(a)(3). The terms "buildings" and "structural components" have the meanings assigned to those terms in Treas. Reg. § 1.48-1(e). Treas. Reg. § 1.1245-3(c)(2).

A building is defined in Treas. Reg. § 1.48-1(e)(1) as any structure or edifice enclosing a space within its walls, and usually covered by a roof, the purpose of which is, for example, to provide shelter or housing or to provide working, office, parking, display, or sales space. The term includes, for example, structures such as apartment houses, factory and office buildings, warehouses, barns, garages, railway or bus stations, and stores. Such term includes any such structure constructed by, or for, a lessee even if such structure must be removed, or ownership of such structure reverts to the lessor, at the termination of the lease. The term "structural components" includes such parts of a building as walls, partitions, floors, and ceilings, as well as any permanent coverings therefor such as paneling or tiling; windows and doors; all components (whether in, on, or adjacent to the building) of a central air conditioning or heating system, including motors, compressors, pipes and ducts; plumbing and plumbing fixtures, such as sinks and bathtubs; electric wiring and lighting fixtures; chimneys; stairs, escalators, and elevators, including all components thereof; sprinkler systems; fire escapes; and other components relating to the operation or maintenance of a building.

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Rev. Rul. 74-391, 1974-2 C.B. 9 ("Rev. Rul. 74-391"), considered a raised floor built over an existing floor to permit wiring, air-conditioning ducts, and other services for the computer to be installed. The ruling stated that the raised false floor built on the existing floor was a necessary part of the installation and operation of the computer equipment, an accessory of such equipment and not a "structural component" of the building. The ruling differentiated wood block flooring attached to the existing floor with mastic, holding that the wood block flooring that is a permanent covering of the concrete floor does not qualify as "section 38 property" for investment credit purposes.

Based on the facts developed so far, the taxpayer's situation appears to fall squarely within that ruling. Substantial additional factual development would be required for any attempt at recharacterizing the raised floor as a structural component of the building. Suggestions relating to further factual development are made below.

If additional fact finding does not clearly indicate that the raised floor should be considered a structural component of the building, we believe the raised floor is appropriately placed within Asset Class 57.0 (an activity category). That asset class includes "assets used in wholesale and retail trade, and personal and professional services", which describes Taxpayer's business. The class has a recovery period of 5 years.

We do not concur in your belief that the "unique" test used in Norwest Corporation & Subsidiaries v. Commissioner, T.C. Memo 1995-390, should apply and would cause the raised floor to fall under the "Specific Depreciable Assets Used In All Business Activities" class 00.11, Office Furniture, Fixtures and Equipment (an asset category). We believe the Court in the second Norwest case, Norwest Corporation & Subsidiaries v. Commissioner, 111 T.C. 105 (1998) moved away from the "unique" test and instead held that the priority rule in Rev. Proc. 62-21 is implicit in Rev. Rul. 87-56. This priority is stated in Question 50 of Rev. Proc. 62-21, which states that assets falling within group 1 should first be classified in the appropriate class contained in group 1 (now asset classes 00.11 through 00.4 of Rev. Proc. 87-56). Then the remaining assets are to be classified according to the taxpayer's activity.

In this case, if the raised floor is "Office Furniture, Fixtures and Equipment" it would fall in asset class 00.11, a specific depreciable assets category. We do not believe the raised floor is properly classified as office furniture, fixtures and equipment. Fitting no other specific depreciable asset category, the asset must then be placed in an activity category. We believe the appropriate classification is in Asset Class 57.0 - Distributive Trades and Services (includes assets used in wholesale and retail trade, and personal and professional services), which corresponds to Taxpayer's business.

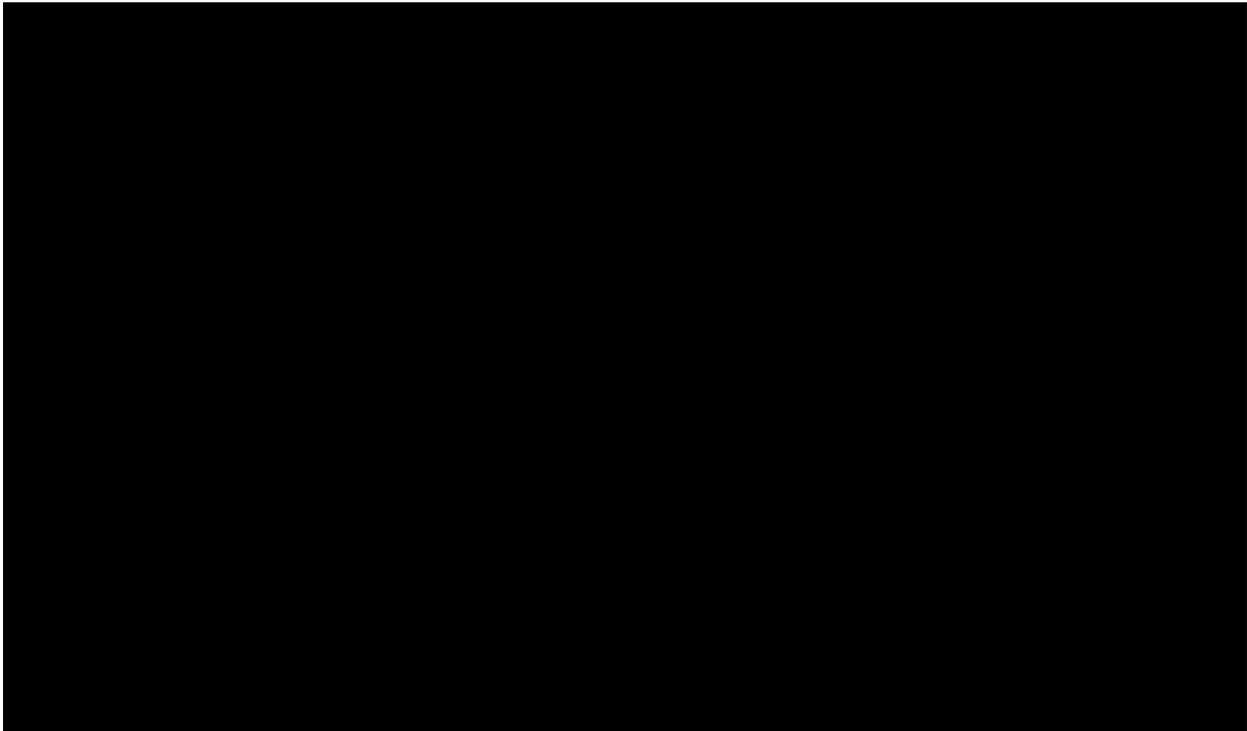
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CASE DEVELOPMENT, HAZARDS AND OTHER CONSIDERATIONS:

If the examining agent wishes to pursue this issue, further factual development is essential. The court in Whiteco Industries, Inc. v. Commissioner, 65 T.C. 664 (1975) cited various factors to consider in analyzing whether particular property is a structural component of a building or depreciable personal property. The include: Whether the property is capable of being moved, and has it in fact been moved?; Whether the property is designed or constructed to remain permanently in place?; Whether there are circumstances which tend to show the expected or intended length of affixation, i.e., are there circumstances which show that the property may or will have to be moved?; How substantial a job is removal of the property and how time-consuming is it? Is it readily movable?; How much damage will the property sustain upon its removal?; and What is the manner of affixation of the property to the land?

To summarize, the factors are whether the property is / was:

CAPABLE OF BEING MOVED - HAS BEEN MOVED
DESIGNED / CONSTRUCTED TO REMAIN IN PLACE
EXPECTED / INTENDED LENGTH OF AFFIXATION
TIME / COSTS REQUIRED FOR REMOVAL
DAMAGE CAUSED BY REMOVAL
MANNER OF AFFIXATION





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