

**Internal Revenue Service**

Department of the Treasury  
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In Re:

Refer Reply To:  
CC:ITA:B03 – PLR-159495-02

Date:  
September 11, 2003

**LEGEND**

Taxpayer =  
designation a =  
business b =  
service c =  
d =

Taxpayer:  
EIN:

Dear \_\_\_\_\_ :

This letter is in response to your request on behalf of Taxpayer for a private letter ruling providing that certain activities of the Taxpayer come within the scope of Revenue Procedure 2002-12, 2002-3 I.R.B. 374 and, therefore, Taxpayer is permitted to use the safe harbor method of accounting for “smallwares” permitted under the revenue procedure.

**FACTS**

Taxpayer is a domestic corporation that has an election under Subchapter S in effect for Taxable Year. The principal business activity code on the Taxpayer’s federal income tax return is designation a with a business description of business b and product service listed as service c.

Taxpayer specializes in providing coffee and related food and refreshment products and small appliances to customers via a national network of route sales personnel. Sales personnel and field technicians are assigned routes, i.e., designated areas, throughout the United States.

Taxpayer is engaged in several related lines of business: the office beverage and breakroom supplies line; the food service line; and within the food service line, the d line. Through the office beverage and breakroom supplies line, Taxpayer provides a wide products, such as coffees, teas, sweeteners, juices, soups, creamers, cups, plastic flatware, etc. for consumption by the customer's employees and visitors. Taxpayer typically contracts with, and is paid by, the institution in which the services and appliances are provided, and not the ultimate consumer of the product.

Taxpayer purchases products, such coffees, teas, and other food items from vendors. Taxpayer does not manufacture any of the products it sells. In addition to providing food and beverages to its customers, Taxpayer also provides appliances. These appliances include coffee brewers, coffee grinders, cappuccino machines, espresso machines, single-cup coffee machines, iced tea brewers, hot beverage thermos, cold beverage urns, microwaves, warmer plates, decanters, small soda fountain machines that dispense soft drinks, filtered water apparatus, and cabinets and stands for brewers, and other appliances.

The route sales personnel service customers by keeping beverage and food items in stock and also perform minor in-field maintenance and repairs to Taxpayer's small appliances, which are generally placed at no-additional cost for customers at their business premises. Approximately every three weeks, route sales personnel place orders for merchandise which includes coffee, teas, juices, soups, sweeteners, condiments' popcorn, and a variety of food and related non-food items.

Taxpayer's food service line includes customers such as convenience stores, supermarket delis, fast food outlets, and other recreational locations. The primary difference between the food service line and the office beverage and breakroom supplies line is the size of the appliances used by the customer. For example, coffee brewers used in the food service line have a greater capacity and included those with up to five warmers.

Within the food service line, Taxpayer conducts some of its business under alliances with food service companies pursuant to which it is the preferred beverage service provider for dining clients. These alliance members are contract food service companies with many locations. Taxpayer provides the beverage service portion of the larger food service operation. Under one such agreement, Taxpayer operates some routes that exclusively serve the alliance member. Taxpayer's employee goes from one beverage service area to another, stocks products, maintains the brewer, cleans the brewer and other equipment, and brews fresh coffee as needed.

As a general rule, it is difficult to predict the useful life of the appliances provided by Taxpayer since they are relatively inexpensive (under \$500), sustain significant wear and tear, and are subject to repeated repairs. Most of the small appliances used by Taxpayer do not have unique serial numbers. Rather, they are tracked by an identifying number based on the type of appliance. Because this information is maintained by Taxpayer, it is capable of identifying and segregating items that may or may not qualify as smallwares under Rev. Proc. 2002-12.

### LAW

Section 162(a) of the Internal Revenue Code allows a deduction for ordinary and necessary expenses paid or incurred during the taxable year in carrying on a trade or business. Under § 1.162-3 of the Income Tax Regulations, the cost of materials and supplies (other than incidental materials and supplies) may be deducted to the extent that the materials and supplies are actually consumed and used in the taxpayer's business during the taxable year.

Section 263(a) provides that no deduction is allowed for the cost of new buildings or of permanent improvements or betterments made to increase the value of any property or estate. Section 1.263(a)-2(a) provides examples of capital expenditures, such as the cost of acquisition, construction, or erection of buildings, machinery and equipment, furniture and fixtures, and similar property having a useful life substantially beyond the taxable year.

Rev. Proc. 2002-12 provides taxpayers engaged in the trade or business of operating a restaurant or tavern with a safe harbor method of accounting for the cost of smallwares. For this purpose, a taxpayer is engaged in the trade or business of operating a restaurant or tavern if the taxpayer's business consists of preparing food and beverages to customer order for immediate on-premises or off-premises consumption. These businesses include, for example, full-service restaurants; limited-service eating places; cafeterias; special food services, such as food service contractors, caterers, and mobile food services; and bars, taverns, and other drinking places. The trade or business of operating a restaurant or tavern may include food or beverage services at grocery stores, hotels and motels, and social or recreational facilities. Smallwares include small appliances that cost \$500 or less and service items. Small appliances include ice tea dispensers, individual food warmers, heat lamps, blenders, juicers, and nonindustrial mixers. Service items include pepper mills, pitchers, and coffee pots.

Taxpayers within the scope of Rev. Proc. 2002-12, are permitted to account for smallwares in the same manner as materials and supplies that are not incidental under § 1.162-3. For purposes of the revenue procedure, smallwares are treated as consumed and used in the taxpayer's business in the year in which they are received at

the restaurant and are available for use. This does not include smallwares purchased and stored at a warehouse or facility other than the restaurant where they will be used.

The safe harbor method of accounting for smallwares provided in Rev. Proc. 2002-12 was intended to resolve disputes concerning whether the cost of smallwares should be accounted for as currently deductible expenses under § 162 or capital expenditures within the meaning of § 263, and to simplify the record keeping requirements with respect to smallwares.

### ANALYSIS

Taxpayer argues that its activities come within the scope of those listed in Rev. Proc. 2002-12 because the Taxpayer's equipment is the same as that used in restaurants and taverns, the tracking and administrative problems are the same as those encountered by restaurants and taverns, and it is providing coffee and related items to customers. Additionally, Taxpayer argues that in many of its contracts, particularly those in the d line, it provides a significant service component in the preparation of beverages for immediate customer consumption within the meaning of the revenue procedure.

In its original submission, Taxpayer proved that its equipment is of the type that would be used in restaurants and taverns. This equipment, which is of relatively small value and is located in various locations, provides tracking and administrative problems similar to those experienced by more traditional restaurants and taverns. At the taxpayer conference of right, the Service informed Taxpayer that many of its activities appeared outside the scope of Rev. Proc. 2002-12 because the service provided by the taxpayer in most circumstance is that of making the equipment and supplies necessary to prepare a beverage available to the ultimate consumer, rather than preparing the beverage. Taxpayer responded with supplemental information that some of its contracts within the d line entail more direct beverage preparation activities.

Rev. Proc. 2002-12 requires that an eligible taxpayer's business consist of preparing food and beverage to customer order for immediate on-premises or off-premises consumption. To the extent Taxpayer's employees routinely engage in beverage preparation using the appliances and supplies described above, Taxpayer's activities are within the scope of the revenue procedure. Thus, where Taxpayer's employees are regularly in attendance during a facility's operating hours and are monitoring the operation of appliances and directing providing the supplies needed for beverage production to these appliances, Taxpayer is within the scope of the revenue procedure. However, where Taxpayer's employees only occasionally prepare beverages, such as preparing a fresh pot of coffee after a once-every-three-week visit to clean and restock a breakroom, Taxpayer is not within the scope of the revenue procedure.

### **CONCLUSION**

Accordingly, based upon your submission and the above analysis, we rule that:

Taxpayer comes within the scope of Rev. Proc. 2002-12 for those contracts within the d line pursuant to which Taxpayer's employees are routinely directly involved in making beverage at the customer's location, and therefore, is permitted to use the smallwares safe harbor method described in section 5 of Rev. Proc. 2002-12 for the cost of the smallwares used in those contracts.

### **CAVEATS**

Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect or any item discussed or referenced in this letter. The ruling is directed only to the taxpayer requesting it. Section 6110(k)(3) provides that it may not be used or cited as precedent.

Sincerely,

Robert M. Casey  
Senior Technician Reviewer  
Office of Associate Chief Counsel  
(Income Tax & Accounting)

cc:

