Section 167.—Depreciation

26 CFR 1.167(a)–11: Depreciation based on class lives and asset depreciation ranges for property placed in service after December 31, 1970.

A safe harbor method is provided under which the Service will treat a node and fiber optic cable used in a cable television distribution system providing one-way and two-way communication services as the unit of property for computing depreciation under sections 167 and 168 of the Internal Revenue Code. See Rev. Proc. 2003-63, page 304.

Section 168.—Accelerated Cost Recovery System

A safe harbor method is provided under which the Service will treat a node and fiber optic cable used in a cable television distribution system providing one-way and two-way communication services as the unit of property for computing depreciation under sections 167 and 168 of the Internal Revenue Code. See Rev. Proc. 2003-63, page 304.

Section 446.—General Rule for Methods of Accounting

26 CFR 1.1446–1: General rule for methods of accounting.

A safe harbor method is provided under which the Service will treat a node and fiber optic cable used in a cable television distribution system providing one-way and two-way communication services as the unit of property for computing depreciation under sections 167 and 168 of the Internal Revenue Code. See Rev. Proc. 2003-63, page 304.

Section 481.—Adjustments Required by Changes in Method of Accounting

A safe harbor method is provided under which the Service will treat a node and fiber optic cable used in a cable television distribution system providing one-way and two-way communication services as the unit of property for computing depreciation under

sections 167 and 168 of the Internal Revenue Code. See Rev. Proc. 2003-63, page 304.

SECTION 1. PURPOSE

This revenue procedure provides a safe harbor method under which the Internal Revenue Service will treat a fiber optic node and trunk line consisting of fiber optic cable used in a cable television distribution system providing one-way and two-way communication services as the unit of property for computing depreciation under §§ 167 and 168 of the Internal Revenue Code.

SECTION 2. BACKGROUND

.01 Cable television companies provide broadcast and video programming to subscribers. In recent years, many companies have upgraded their systems to provide new cable services such as digital television, internet access through a cable modem, and telephony. Upgraded systems use fiber optic cable because optic fibers have immense capacity and are reliable, and transmissions over them are not susceptible to interference by outside signals. The fiber optic strands of glass (optic fibers) within fiber optic cables carry analog or digital signals in the form of light waves. In comparison, coaxial cable carries radio frequency signals. Bandwidth is the range of radio frequencies or light spectrum available for use by cable television distribution systems for transmission.

.02 The design of cable television distribution systems varies considerably throughout the country. Programming normally originates from an antenna, satellite, microwave, film, or videotape and is fed into the headend. The headend is electronic equipment that receives programming signals and combines, amplifies, and converts the programming signals for transmission throughout the system. The distribution plant conveys the programming signals from the headend to subscribers. The distribution plant generally consists of optic transmission and receiver devices, fiber optic cable (used as trunk lines), fiber optic transfer nodes ("nodes" containing optical receivers and reverse optical transmitters), coaxial cable (used as feeder or distribution cables), amplifiers, taps, and coaxial drop cables to the subscribers' properties.

.03 A fiber optic cable usually contains several bundles of optic fibers. Many cable television distribution systems dedicate one bundle from the headend to each node. The nodes are the point of interface between the fiber optic cable and the feeder or distribution cables, which carry the signals to, and past, subscribers' properties. Fiber optic cable and node function together as an integrated unit. Nodes, however, are not usually interconnected or dependent on one another; each node operates independently of other nodes.

.04 Subscribers generally cannot receive two-way communication services until the node serving them is connected to the equipment necessary for the services. In order to provide two-way communication services, usually two optic fibers are connected between the headend and the node, even though the bundle of fibers dedicated to the node may contain more than two fibers. Typically, one optic fiber is used for transmitting data downstream from the headend to subscribers and another optic fiber is used for transmitting data upstream from subscribers.

.05 Section 167(a) provides that there shall be allowed as a depreciation deduction a reasonable allowance for the exhaustion, and wear and tear of property used in a trade or business or held for the production of income.

.06 The depreciation deduction provided by § 167(a) for tangible property placed in service after 1986 generally is determined under § 168. Section 168 prescribes two methods of accounting for computing depreciation: the general depreciation system in § 168(a); and the alternative depreciation system (ADS) in § 168(g). Under either depreciation system, the depreciation deduction is computed by using a prescribed depreciation method, recovery period, and convention.

.07 Rev. Proc. 87–56, 1987–2 C.B. 674, as clarified and modified by Rev. Proc. 88–22, 1988–1 C.B. 785, sets forth the class lives of property that are necessary to compute depreciation under § 168. Rev. Proc. 87–56 prescribes asset class 48.41, "CATV [Cable Television]-Headend," which includes assets

such as towers, antennas, preamplifiers, converters, modulation equipment, and program non-duplication systems. This asset class has a class life of 11 years, which means that the property in this asset class is classified as 7-year property under § 168(e)(1) with an applicable recovery period of 7 years under § 168(c) and a recovery period of 11 years under § 168(g).

.08 Rev. Proc. 87–56 prescribes Asset Class 48.42, "CATV-Subscriber Connection and Distribution Systems," which includes assets such as trunk and feeder cable, connecting hardware, amplifiers, power equipment, passive devices, directional taps, pedestals, pressure taps, drop cables, matching transformers, multiple set connector equipment, and converters. This asset class has a class life of 10 years, which means that the property in this asset class is classified as 7-year property under § 168(e)(1) with an applicable recovery period of 7 years under § 168(c) and a recovery period of 10 years under § 168(g). Rev. Proc. 87–56 excludes from CATV asset classes 48.41 and 48.42 assets used to provide subscribers with two-way communication services.

.09 Rev. Proc. 87–56 assigns a class life of 24 years to property described in asset classes 48.31 to 48.45 that is comparable to property described in asset class 48.14, "Telephone Distribution Plant," and used for two-way exchange of voice and data communication which is the equivalent of telephone communication. Comparable equipment does not include cable television equipment used primarily for one-way communication. See also § 168(e)(3)(E)(ii) and § 168(g)(3)(B), under which any telephone distribution plant and comparable equipment used for two-way exchange of voice and data communications is 15-year property with an applicable recovery period of 15 years under § 168(c) and a recovery period of 24 years under § 168(g).

.10 Under § 1.167(a)–11(b)(4)(iii)(*b*) of the Income Tax Regulations, property is included in the asset guideline class for the activity in which the property is primarily used. Property is classified according to primary use even though the activity in which such property is primarily used is insubstantial in relation to all the taxpayer's activities.

.11 Property is first placed in service in the taxable year in which the property is placed in a condition or state of readiness and availability for a specifically assigned function, whether in a trade or business, in the production of income, in a tax-exempt activity, or in a personal activity. *See* § 1.46–3(d)(1)(ii).

SECTION 3. SCOPE

.01 *Applicability*. This revenue procedure applies to taxpayers operating cable television distribution systems designed to provide one-way and two-way communication services to subscribers.

.02 *One-way and two-way communication services*. For purposes of this revenue procedure, one-way communication services involve services in which broadcast and video programming signals are sent only downstream, that is, from the headend to subscribers; and two-way communication services involve services in which property is used for the two-way exchange between the headend and subscribers of voice and data communications which is the equivalent of telephone communication. Internet access through a cable modem and telephony (including IP (internet protocol) telephony also known as voice-over IP) are examples of two-way communication services.

SECTION 4. SAFE HARBOR METHOD

.01 *Unit of Property*. The unit of property for calculating depreciation under §§ 167 and 168 is a node and the fiber optic cable to that node, exclusive of any fiber optic cable previously considered placed in service under section 4.03 of this revenue procedure and any optic fibers sold by a taxpayer. Thus, for example, if a taxpayer has a fiber optic cable containing 20 bundles of 6 optic fibers (120 total optic fibers) and connects 2 optic fibers to a node, the fiber optic cable (including all 120 optic fibers) is a component of the unit of property.

.02 *Determining primary use*. In determining whether the unit of property described in section 4.01 of this revenue procedure is primarily used, within the meaning of § 1.167(a)–11(b)(4)(iii)(*b*), for providing one-way or two-way communication services, a cable television company must determine primary use by using any reasonable manner that is consistently applied to the taxpayer's units of property described in section 4.01 of this revenue procedure. If the unit of property is primarily used for providing one-way communication services, the unit of property is assigned to asset class 48.42, "CATV-Subscriber Connection and Distribution Systems," and classified as 7-year property under § 168(e)(1) with an applicable recovery period of 7 years under § 168(c) and a recovery period of 10 years under § 168(g). However, if the unit of property is primarily used for providing two-way communications services, § 168(e)(3)(E)(ii) classifies the unit of property as 15-year property with an applicable recovery period of 15 years under § 168(c) and a recovery period of 24 years under § 168(g). For purposes of this revenue procedure, a cable television company may determine primary use based on either: the node within the unit of property described in section 4.01 of this revenue procedure; or the applicable cable television distribution system for each headend, provided the cable television company maintains its books and records based on each headend.

(1) *Reasonable manner*. A reasonable manner includes, but is not limited to, determining primary use by gross receipts or by subscriber count for each service within the applicable cable television distribution system. However, for purposes of this safe harbor method, determining primary use by bandwidth is not considered reasonable.

(2) *Change in primary use*. If the primary use of the unit of property described in section 4.01 of this revenue procedure changes from providing either one-way communication services to two-way communication services, or two-way communication services to one-way communication services, § 168(i)(5) applies beginning in the year of the change in use.

.03 *Placed in service*. The unit of property described in section 4.01 of this revenue procedure is considered placed in service for depreciation purposes when placed in a condition or state of readiness and availability for its specifically assigned function. The specifically assigned function of a cable television company's distribution system is to provide services to subscribers. Thus, when a node is connected to the equipment necessary for providing one-way or two-way communication services to subscribers or potential subscribers, the property is considered

placed in service for purposes of §§ 167 and 168. Although a fiber optic cable may contain more optic fibers than are necessary to serve a single node, all optic fibers in the unit of property are considered placed in service when the node is ready and available as described above and connected to at least one optic fiber in the fiber optic cable.

.04 *Consistent treatment.* Taxpayers using the unit of property described in section 4.01 of this revenue procedure must use it for all of a headend's nodes and fiber optic cable. Except as provided in section 4.02 of this revenue procedure, taxpayers are required to treat the unit of property consistently for all purposes under §§ 167 and 168 and the regulations thereunder.

SECTION 5. CHANGE IN METHOD OF ACCOUNTING AND AUDIT PROTECTION

.01 *Change in method of accounting.* A change in a taxpayer's depreciation treatment of cable television distribution systems (as described in section 4 of this revenue procedure) is a change in method of accounting to which §§ 446(e) and 481 apply. If a taxpayer within the scope of this revenue procedure wants to change to the safe harbor method provided in this revenue procedure for cable television distribution systems (as described in section 4 of this revenue procedure) that are owned by the taxpayer at the beginning of the year of change, the taxpayer must follow the automatic change in method of accounting provisions in Rev. Proc. 2002–9, 2002–1 C.B. 327 (as modified and amplified by Rev. Proc. 2002–19, 2002–1 C.B. 696, amplified, clarified, and modified by Rev. Proc. 2002–54, 2002–35 I.R.B. 432, and modified and clarified by Announcement 2002–17, 2002–1 C.B. 561) or any successor, with the following modifications:

(1) The scope limitations in section 4.02 of Rev. Proc. 2002–9 do not apply to a taxpayer that wants to change to the safe harbor method for either its first or second taxable year ending after December 31, 2001; and

(2) To assist the Service in processing changes in method of accounting under this section of the revenue procedure, and to ensure proper handling, section 6.02(4)(a) of Rev. Proc. 2002–9 is modified to require that a Form 3115 filed under this revenue procedure include the statement: "Automatic Change Filed Under Rev. Proc. 2003–63." This statement should be legibly printed or typed on the appropriate line on the Form 3115.

.02 *Audit protection.* If a taxpayer currently uses a method consistent with the safe harbor method (as described in section 4 of this revenue procedure), the method of accounting for depreciation of the taxpayer's property described in section 4.01 will not be raised as an issue by the Service in a taxable year that ends before August 11, 2003. Also, if a taxpayer currently uses a method consistent with the safe harbor method (as described in section 4 of this revenue procedure) and its use of that method is an issue under consideration (within the meaning of section 3.09 of Rev. Proc. 2002–9) for taxable years in examination, before an appeals office, or before the U.S. Tax Court in a taxable year that ends before August 11, 2003, that issue will not be further pursued by the Service.

SECTION 6. EFFECT ON OTHER DOCUMENTS

Rev. Proc. 2002–9 is modified and amplified to include this change in method of accounting in section 2 of the APPENDIX.

SECTION 7. EFFECTIVE DATE

This revenue procedure is effective on August 11, 2003.

SECTION 8. DRAFTING INFORMATION

The principal author of this revenue procedure is Paul Handleman of the Office of Associate Chief Counsel (Passthroughs and Special Industries). For further information regarding this revenue procedure, contact Mr. Handleman at (202) 622–3040 (not a toll-free call).