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INTERNAL REVENUE SERVICE NATIONAL OFFICE FIELD SERVICE ADVICE

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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 June 7, 2000, requesting reconsideration of FSA 200033002 dated April 17, 2000. Field Service Advice is not binding on Examination or Appeals and is not a final case determination. This document is not to be used or cited as precedent.

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official tax administration duties with respect to the case and the issues discussed in the document require inspection or disclosure of the Field Service Advice.

LEGEND

Taxpayer =
 Tax Year =
 Amount-1 =

ISSUES

FSA 200033002 addressed the following 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 section 168 of the Internal Revenue Code or a structural component of a building?
2. If the raised floor is personal property under section 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?

CONCLUSIONS

Issue 1: Based on the facts submitted, we believe an argument can be made that the raised floor in this case is distinguishable from the raised floor discussed in Rev. Rul. 74-391 and should be treated, for depreciation purposes, as a structural component of a building. Because we reach this conclusion, we do not address further Issues 2 and 3.

FACTS

Taxpayer is in the business of providing various computer-related services to banks. During Tax Year, Taxpayer constructed and placed in service an 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 2-foot 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 90 percent of the first floor of the building and encompasses a computer room, printer room, storage rooms, mail room, conference rooms, offices, customer service areas, mechanical and electrical

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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 interior spaces of the building are designed around the raised floor. Doors and ceilings are full height from the top of the raised 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, including the repositioning of all interior doors and frames and the lowering of all electrical outlets, light switches, and thermostat controls. All wiring, ducts, piping, fire alarm, and other equipment under the raised floor would have to be removed.

Taxpayer identified the raised floor as personal property under section 1245. Taxpayer engaged an outside firm to conduct a "cost segregation study" in support of its position regarding the raised floor. Taxpayer claims the raised floor is 5-year property for purposes of section 168.

LAW AND ANALYSIS

Section 167(a) provides a depreciation allowance for the exhaustion, wear and tear of property used in a trade or business or held for the production of income.

The depreciation deduction provided by section 167(a) for tangible property placed in service after 1986 generally is determined under section 168. This section prescribes two methods of accounting for determining depreciation allowances. One method is the general depreciation system in section 168(a) and the other method is the alternative depreciation system in section 168(g). Under either depreciation system the depreciation deduction is computed by using a prescribed depreciation method, recovery period, and convention. The issue presented by the present case concerns the applicable recovery period for the raised floor.

For purposes of either section 168(a) or 168(g), the applicable recovery period is determined by reference to class life or by statute. Section 168(i)(1) provides that the term "class life" means the class life (if any) that would be applicable with respect to any property as of January 1, 1986, under former section 167(m) as if it were in effect and the taxpayer were an elector. Prior to its revocation, section 167(m) provided that in the case of a taxpayer who elected the asset depreciation range system of depreciation, the depreciation deduction would be computed based on the class life prescribed by the Secretary which reasonably reflects the anticipated useful life of that class of property to the industry or other group.

Section 1.167(a)-11(b)(4)(iii)(b) of the Income Tax Regulations sets out the method for asset classification under former section 167(m). Property is included in the asset guideline class for the activity in which the property is primarily used.

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Property is classified according to primary use even though the use is insubstantial in relation to all of the taxpayer's activities.

Rev. Proc. 87-56, 1987-2 C.B. 674, sets forth the class lives of property that are necessary to compute the depreciation allowances under section 168. The revenue procedure establishes two broad categories of depreciable assets: (1) asset classes 00.11 through 00.4 that consist of specific assets used in all business activities; and (2) asset classes 01.1 through 80.0 that consist of assets used in specific business activities. The same item of depreciable property can be described in both an asset category and an activity. See Norwest Corporation & Subsidiaries v. Commissioner, 111 T.C. 105 (1998) (item described in both an asset and an activity category (furniture and fixtures) should be placed in the asset category).

The recovery period of nonresidential real property is established by statute. Nonresidential real property has a recovery period of 39 years (or 31.5 years if the property was placed in service before May 13, 1993) for purposes of section 168(a) and 40 years for purposes of section 168(g). Sections 168(c) and 168(g)(2)(c). Section 168(e)(2)(B) defines "nonresidential real property" as section 1250 property which is not residential rental property or property with a class life of less than 27.5 years.

Section 168(i)(12) provides that "section 1250 property" has the same meaning as given by section 1250(c). Section 1250(c) provides that 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 1245(a)(3) provides that "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 in connection with a qualified activity, (c) a single purpose agriculture or horticultural structure, (d) a storage facility used in connection with the distribution of petroleum. Pursuant to section 1.1245-3(c)(2), the terms "buildings" and "structural components" have the meanings assigned to those terms in section 1.48-1(e).

Section 1.48-1(e)(1) defines a "building" 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.

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Section 1.48-1(e)(2) provides that 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.

Section 1.48-1(c) provides that buildings and other inherently permanent structures (including items which are structural components of such buildings or structures) are not tangible personal property. Tangible personal property may qualify as section 38 property.

Rev. Rul. 74-391, 1974-2 C.B. 9, considered a raised floor built over an existing floor to permit wiring, air-conditioning ducts, and other services for computer equipment to be installed. The ruling concluded 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. Therefore, the ruling concluded that the raised floor qualified as section 38 property. The ruling differentiated wood block flooring attached to the existing floor with mastic, holding that the wood block flooring was a permanent covering of the concrete floor and did not qualify as section 38 property for investment credit purposes.

Rev. Rul. 74-391 also considered two categories of catwalks erected in the building. Some catwalks were erected to provide access for the inspection, operation, and maintenance of specific machinery and equipment. Other catwalks were erected to provide access to various sections and levels of the building. The ruling concludes that catwalks in the first category are essentially parts of specific items of equipment and qualify as section 38 property, while catwalks in the second category serve the function of building stairways and hallways and, therefore, are structural components of the building that do not qualify as section 38 property.

Metro National Corp. v. Commissioner, 52 TCM 1440 (1987), considered whether various items in the taxpayer's buildings were section 38 property. The court found that the structural components listed in section 1.48-1(e)(2) share the common characteristic of reasonable permanency. The court stated that ordinarily a building is designed and constructed with the expectation that the components listed in the regulation will remain in place indefinitely, and that such components are usually integrated with the building during the construction phase. In determining whether

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a particular item was a structural component the court looked to whether the item was incorporated in the original plan, design, and construction of the building.

Hospital Corp. of America v. Commissioner, 109 T.C. 21 (1997) ("HCA"), considered whether various items in the taxpayer's buildings were structural components of buildings or section 1245 property for depreciation purposes. In making this determination the court employed the factors set forth in Whiteco Indus., Inc. v. Commissioner, 65 T.C. 664, 672-673 (1975), to ascertain whether the items were inherently permanent and, accordingly, structural components. These factors are:

- (1) Is the property capable of being moved, and has it in fact been moved?
- (2) Is the property designed or constructed to remain permanently in place?
- (3) Are there 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 be moved?
- (4) How substantial a job is removal of the property and how time consuming is it; is it readily removable?
- (5) How much damage will the property sustain upon its removal?
- (6) What is the manner of affixation to the land?

The court in HCA also stated that "an item constitutes a structural component of a building if the item relates to the operation and maintenance of the building." 109 T.C. at 58.

L.L. Bean, Inc. v. Commissioner, 73 TCM 2560 (1997), considered whether a storage facility, known as the "mezzanine system," located within the taxpayer's shipping building was section 38 property. The mezzanine system, part of the original construction plan when the shipping building was designed, did not support the ceiling or walls of the shipping building, but it did support the mezzanine floor, thereby reducing construction costs and increasing storage space. Various other elements were connected to, or suspended from the underside of, the mezzanine system, including cable, electricity and communications, lighting fixtures, and sprinkler piping. The mezzanine floor was the first stop for freight elevators located in the center of the building. The court found that the building was planned and designed with the integration of the mezzanine system in mind and concluded that the substantial time and effort involved in both the construction and potential removal of the system, as well as the degree of its integration with the building, reflected the permanent nature of the system. The court also concluded that these

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factors indicated that the mezzanine system was related to the operation and maintenance of the shipping building, the criterion used by the Tax Court in HCA.

In L.L. Bean, the court also considered whether a facility of the taxpayer's could be considered an improvement to land because it was movable. The court stated that proper application of the Whiteco factors rests on the premise that movability itself is not the key determinant of lack of permanence, and the mere fact that the taxpayer's facility could theoretically be moved did not establish that it was not inherently permanent. See also HCA, 109 T.C. at 57. In finding that the taxpayer's facility was inherently permanent the court noted that the facility was specifically designed for the site as an addition to taxpayer's distribution center and that the time and effort involved to move the facility would be substantial.

In the present case, Taxpayer contends that the raised floor is properly classified as tangible personal property and should be depreciated using a 5-year recovery period. The examining agent believes the raised floor is a structural component of the building and should be classified as nonresidential real property for depreciation purposes. FSA 200033002 concluded that, based on the current factual development of the case, Taxpayer's raised floor, like the raised floor in Rev. Rul. 74-391, was not a structural component of a building. As discussed below, after review of all the material submitted, we believe an argument can be made that the raised floor in this case is distinguishable from the raised floor in Rev. Rul. 74-391 and should be treated, for depreciation purposes, as a structural component of a building.

We believe the facts of the present case are distinguishable from those of Rev. Rul. 74-391. In the revenue ruling, the raised floor was installed over an existing floor in order to accommodate specific computer equipment located in a limited area. The removal of this addition to the building would return the building to its original condition and would not result in extensive renovations or loss of functionality. In contrast, Taxpayer's raised floor encompasses 90% of the first floor and only a portion of this percentage is related to computer usage. The floor is found in many different areas, including offices and storage rooms. Taxpayer's raised floor was incorporated into the original design of the building and integrated with the interior partitions and doors. In addition, electrical outlets, switches, and other controls were positioned with the raised floor in mind. There is no finished floor under Taxpayer's raised floor and its removal would require a major renovation of the interior of the building because of the integration of the building's design with the floor. Further, removal of Taxpayer's raised floor would also require removal of wiring, plumbing, and ventilation components located under the floor unless another raised floor were installed.

Based on the preceding discussion, we believe the raised floor in the present case is significantly different from the floor considered in Rev. Rul. 74-391. We suggest

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that Taxpayer's raised floor is more akin to the catwalks discussed in the revenue ruling that were held to be structural components of a building because they served the function of building stairways and hallways. Because of the integrated design of the first floor, Taxpayer's raised floor serves the function of a building floor and relates to the operation and maintenance of the building. This relationship indicates the raised floor is a structural component of the building. The fact that this particular raised floor was part of the original design and construction of the building is also indicative of structural component status. See HCA, L.L. Bean, and Metro. Taxpayer's raised floor is analogous to the mezzanine system considered by the court in L.L. Bean. Like the mezzanine system, the raised floor's degree of integration with the building indicated by the positioning of doors, electrical outlets, switches and other controls, and by the subfloor placement of wiring, plumbing, and ventilation components, reflects the permanent nature of the floor.

We now consider, in light of the Whiteco factors, the movability aspect of Taxpayer's raised floor because inherent permanence is indicative of a structural component. HCA. While Taxpayer's floor certainly can be moved, proper application of the Whiteco factors rests on the premise that movability itself is not the key determinant of lack of permanence. L.L. Bean; HCA. As discussed in the preceding paragraph, Taxpayer's raised floor was part of the original design of the building, and the degree of integration with the building suggests permanent installation. Taxpayer has no plans to remove the floor and there would be no particular reason to do so even if the building's use changed. Removal of the floor would require substantial renovations to the building during which time the entire first floor would be unavailable for use. Accordingly, we believe an argument can be made that application of the Whiteco factors to the design of Taxpayer's raised floor does not indicate a lack of permanence.

CASE DEVELOPMENT, HAZARDS AND OTHER CONSIDERATIONS:



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If you have any questions regarding this Field Service Advice, please call (202) 622-3110.

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