Internal Revenue Service

Index Number: 168.20-00
48.01-00 R 90

Department of the Treasury

200013038

Washington, DC 20224

Person to Contact:

Telephone Number:

Refer Reply To:
CC:DOM:P&SI:6 PLR-105294-99

Date:
DEC 27 1999

Taxpayer =

Parent =

District =
Facility =
Government Agency=
Complex =
Site =
City =
Plant =
State =
Act1 =
Act2 =

a =
b =
c =
d =
e =
f =
g =
h =
i =
j =
k =
l =
m =
n =
o =
p =
q =
r =
s =
t =

248

u =
v =
w =
x =

Dear :

This letter responds to a letter, dated March 6, 1999, and subsequent correspondence, submitted on behalf of Taxpayer, requesting a letter ruling on the classification of the Facility for purposes of § 168 of the Internal Revenue Code.

Taxpayer represents that the facts relating to its request are as follows:

Taxpayer belongs to a consolidated group of corporations under Parent and uses the accrual method of accounting. Taxpayer is under the examination jurisdiction of the District office of the Internal Revenue Service.

Taxpayer is currently planning the construction and operation of the Facility which is designed to process a waste. The Facility is a result of a contract awarded to Taxpayer by the Government Agency. The Facility will be located in Complex which is part of Site and is approximately b miles west of City. Complex is wholly dedicated to the environmentally safe storage and disposal of a waste. Site's land is owned by the c and is under the Government Agency's stewardship. All of the activities on Site are controlled and regulated by d.

Over an approximate e year operating period, the Facility will process a waste into a safe, stable waste product suitable for transportation, long-term storage at an off-site repository, and ultimate disposal. Approximately f cubic meters of a waste located at Complex will be processed. Specifically, the Facility will process g waste and h waste. The waste consists of items such as clothing, rags, equipment, tools, and sludge that were contaminated with i during the manufacture of j components.

The initial step in production is the retrieval and characterization of the waste. Then, the waste is processed. Taxpayer plans to use the following types of waste treatment:

249

All of the equipment required for the various types of waste treatment are housed in the Facility. Significant areas of the waste treatment process are fully automated. Finally, Taxpayer will package the waste for shipment to the Plant in State.

The construction of the Facility structure and the installation of the major equipment have to be completed in parallel. For example, construction of the structure could be partially completed to enable provision for equipment installation. Large equipment pieces may be installed early in the construction schedule and the necessary portions of the structure would be erected around it. In addition, because of the a waste to be processed at the Facility, it contains specialized features to ensure that all k is contained within the Facility during the processing of the wastes and that no release of l material is made to the environment. These features include that essentially "wrap" around the processing equipment to provide shielding from the effects of m, and

that ensure the total containment of the a material.

Employee activity will be either based within the Facility itself or at office locations at some distance from the Facility. The employees based in the offices away from the Facility will generally undertake the administrative, functional, and support duties (for example, accounting, technical support, secretarial, etc.). Within the Facility, only the main operations and required, on-site safety and maintenance will be based. There will be n alternative shift teams of about o employees each with no more than one shift team deployed at a given time, coupled with approximately a p day-only staff. Because of the automated nature of the waste processing treatment process, the extent of employee involvement often consists of monitoring activities. Most employee activity is principally limited to the central control room area and workstation areas. The responsibilities of the operators and management in the central control room area include . The employees who will occupy the stations at the "box lines" and "drum lines" will

. Other employees within the Facility will perform repair and maintenance tasks, incidental duties of cleaning, monitoring equipment condition, inspections, and other manual operation tasks.

As a result of portions of the interior of the Facility becoming l, Taxpayer is required, pursuant to its contract with the Government Agency, to close, q, and r the Facility at the completion of the operations period. At that time, Taxpayer will contemporaneously retire the Facility and equipment by entering into a two-stage closure. In the first stage, Taxpayer will q and r the Facility and equipment according to

250

procedures defined by the Act. The goal of the first stage is to control and prevent escape of l materials in order to protect human health and the environment. The second stage involves the demolition of the Facility and equipment as well as the disposal of the debris in a safe repository. The goal of the second stage is to restore Site to a "greenfield" space.

There is no feasible alternative use for the Facility. The Facility is designed to process a specific type of waste form using specific types of technologies and processing stages. Continued use of the Facility for waste treatment would involve treating other a waste compatible with the Facility waste acceptance criteria. Studies show that insignificant amounts of waste that fit the acceptance criteria are located at Site but not on Complex. Further, significant d regulatory complexities would severely hamper transportation of a waste from other locations and the cost associated with safely transporting large volumes of such waste would be enormous. Moreover, under Taxpayer's contract with the Government Agency, Taxpayer cannot use the Facility for any purpose other than the treatment of the Government Agency's a waste.

In addition, significant practical barriers exist to alternative uses. The Facility will be located on a parcel of land inside the Complex, which is partitioned into two site areas, the s and the t. The whole site is currently classified as a "u" site under the Act2. The Facility is physically located inside the t and, hence, inside the fence controlling the u site. Due to the likely k of t land attributable to v from the s, as well as the longer w horizon of the s (planned to be under long-term institutional control and Government Agency regulation), it is extremely unlikely that the fence would be rerouted when the Facility is dismantled.

Moreover, the cost of adapting the Facility for alternative uses would be prohibitively expensive. The operating areas of the Facility would have to be x sufficiently to the level necessary to allow free and unrestricted access and to undertake alternative operations therein. Further, the land on which the Facility is located would have to be x to enable unrestricted commercial construction activities. Taxpayer believes the costs to do either would be prohibitive.

Unrelated, but relatively less l, Government Agency sites have shown a history of non-reuse of facilities. For the Site, there is no intention to reclaim the a Facility at the end of its useful life for alternative uses.

Rulings Requested

Taxpayer requests rulings that for purposes of § 168, the Facility (exclusive of the equipment contained therein): (1) is not a building within the meaning of § 1.48-1(e) of the Income Tax Regulations; and (2) is included in asset class 49.5, Waste Reduction and Resource Recovery Plants, of Rev. Proc. 87-56, 1987-2 C.B. 674, and is classified as 7-year property under § 168(e).

251

Issue 1

Law and Analysis

Section 167(a) provides that there is allowed as a depreciation deduction a reasonable allowance for the exhaustion, wear and tear (including a reasonable allowance for obsolescence) of property used in the trade or business, or of property held for the production of income. Section 168(a) provides that for depreciable tangible property placed in service after 1986, the depreciation deduction provided by § 167(a) generally is determined by using the applicable depreciation method, recovery period, and convention.

The classification of property for purposes of § 168 is determined under § 168(e). Section 168(e)(2)(B) defines nonresidential real property as meaning section 1250 property that is not residential rental property or property with a class life of less than 27.5 years. Section 168(i)(12) defines the term "section 1250 property" as having the meaning given such term by § 1250(c). Pursuant to § 1250(c), section 1250 property is any real property (other than section 1245 property as defined in § 1245(a)(3)) that is or has been property of a character subject to the allowance for depreciation provided in § 167. Section 1245(a)(3) and § 1.1245-3(c) provide that section 1245(a)(3) property does not include a building or its structural components as defined in § 1.48-1(e).

Section 1.48-1(e)(1) provides that the term "building" generally means 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. Such term does not include (i) a structure which is essentially an item of machinery or equipment, or (ii) a structure which houses property used as an integral part of an activity specified in former § 48(a)(1)(B)(i) if the use of the structure is so closely related to the use of such property that the structure clearly can be expected to be replaced when the property it initially houses is replaced. Factors which indicate that a structure is closely related to the use of the property it houses include the fact that the structure is specifically designed to provide for the stress and other demands of such property and the fact that the structure could not be economically used for other purposes. (In this regard, note also section 5.05 of Rev. Proc. 87-56 for similar language regarding asset class 00.3, Land Improvements, which is discussed below.)

The activities specified in former § 48(a)(1)(B)(i) include, among other things, manufacturing, production, and extraction. Section 1.48-1(d)(2) provides that the terms "manufacturing", "production", and "extraction" include the construction, reconstruction, or making of property out of scrap, salvage, or junk material, as well as from new or raw material, by processing, manipulating, refining, or changing the form of an article, or by combining or assembling two or more articles.

The Facility is a structure enclosing a space within its walls, covered by a roof, and provides shelter, and work space. However, even though a structure meets the appearance and function tests in § 1.48-1(e), the structure may not be classified as a building if it meets one of the two exceptions provided in § 1.48-1(e). The first exception to the definition of a building is that it is a structure which is essentially an item of machinery or equipment. Taxpayer asserts that the Facility is essentially an item of equipment because the function of the Facility is so closely related to the function of the equipment that the two are unitary. Taxpayer relies on Weirick v. Commissioner, 62 T.C. 446 (1974), for its reasoning.

Weirick involved the issue of whether the cable-support and holddown towers located between the terminal towers of a chair-type ski lift constituted tangible personal property under § 1.48-1(c). The court found that the line towers were virtually inseparable from the sheave assemblies so that they acted as a unitary mechanism. They were so closely related in design, construction, and function that they cannot be treated realistically as two separate groups of assets.

The court in Illinois Cereal Mills, Inc. v. Commissioner, T.C. Memo 1983-469 (46 T.C.M. (CCH) 1001), in dealing with structures housing certain industrial processes, stated that for a structure to be excluded from the definition of a building due to the first exception listed in § 1.48-1(e)(1), the structure itself must be a part of that industrial process. In this way, the structures themselves would function as machinery or equipment.

In the present case, the perimeter wall of the Facility serves to provide shelter for the equipment and employees therein. The perimeter wall does not itself aid in the processing of a waste and does not act as a unitary mechanism with the equipment it houses. Thus, the Facility is not essentially an item of machinery or equipment.

The second exception to the definition of a building is that it is a structure which houses property used as an integral part of an activity specified in former § 48(a)(1)(B)(i) [including production] if the use of the structure is so closely related to the use of such property that the structure clearly can be expected to be replaced when the property it initially houses is replaced. Factors which indicate that a structure is closely related to the use of the property it houses include the fact that the structure is specifically designed to provide for the stress and other demands of such property and the fact that the structure could not be economically used for other purposes.

In the present case, Taxpayer represents that the Facility will process a waste into a safe, stable waste product suitable for transportation, long-term storage at an off-site repository, and ultimate disposal. Taxpayer further represents that the equipment used in this processing activity is housed in the Facility.

253

Also, the characteristics of the waste to be processed at the Facility prevent it from being used for other reasonable purposes. Taxpayer represents that because portions of the Facility will become l, Taxpayer is required, pursuant to its contract with the Government Agency, to close, q, and r the Facility upon completion of the operations period. At that time, Taxpayer will contemporaneously retire the Facility and equipment by entering into a two-stage closure. In the first stage, Taxpayer will q and r the Facility and equipment according to procedures defined by the Act1. The second stage involves the demolition of the Facility and equipment as well as the disposal of the debris in a safe repository.

In addition, Taxpayer represents that the Facility is designed to process a specific type of waste form using specific types of technologies and processing stages. Continued use of the Facility for waste treatment would involve treating other a waste compatible with the Facility waste acceptance criteria. Studies show that insignificant amounts of waste that fit the acceptance criteria are located at Site but not on Complex. Further, significant d regulatory complexities would severely hamper transportation of a waste from other locations and the cost associated with safely transporting large volumes of such waste would be enormous. Moreover, under Taxpayer's contract with the Government Agency, Taxpayer cannot use the Facility for any purpose other than the treatment of the Government Agency's a waste.

Even if the contract with the Government Agency permitted Taxpayer to use the Facility for other purposes, Taxpayer represents that the cost of adapting the Facility for alternative uses would be prohibitively expensive. The operating areas of the Facility would have to be x sufficiently to the level necessary to allow free and unrestricted access and to undertake alternative operations therein. Further, the land on which the Facility is located would have to be x to enable unrestricted commercial construction activities.

Moreover, Taxpayer represents that significant practical barriers exist to alternative uses. Because the Facility is physically located inside the t, it is inside the fence controlling the u site. Due to the likely k of t land attributable to v from the s, as well as the longer w horizon of the s, it is extremely unlikely that the fence would be rerouted when the Facility is dismantled.

Because the Facility houses equipment that is used as an integral part of production and the Facility itself is so closely related to the use of this equipment that the Facility clearly can be expected to be replaced when the equipment is replaced, the Facility falls within the second exception to the definition of a building under § 1.48-1(e). Therefore, the Facility is not a building within the meaning of § 1.48-1(e).

254

Issue 2

Law and Analysis

For purposes of § 168, § 168(e)(1) provides that 7-year property is property with a class life of 10 or more years but less than 16 years. Section 168(i)(1) defines the term "class life" as meaning the class life (if any) that would be applicable with respect to any property as of January 1, 1986, under former § 167(m) as if that section was in effect on the day before the date of enactment of the Revenue Reconciliation Act of 1990 and as if the taxpayer had made an election under former § 167(m).

Former § 167(m) provided an election to compute the depreciation allowance by use of class lives established by the Secretary. The manner of determining a class life is set out in §§ 1.167(a)-11(b)(4)(ii) and 1.167(a)-11(b)(4)(iii)(b). Those sections provide that property is included in the asset class established and periodically published in revenue procedures (Rev. Proc. 87-56, which is in effect for § 168, is discussed below). Property is included in the asset class for the activity in which the property is primarily used.

The asset classes and class lives for property subject to depreciation under § 168 are set forth in Rev. Proc. 87-56. This revenue procedure divides assets into two broad categories: (1) asset classes 00.11 through 00.4 that consist of specific depreciable assets used in all business activities; and (2) asset classes 01.1 through 80.0 that consist of depreciable assets used in specific business activities.

Asset class 49.5, Waste Reduction and Resource Recovery Plants, of Rev. Proc. 87-56, includes material recovery and support assets used in refuse, solid refuse, or solid waste receiving, collecting, handling, sorting, shredding, classifying, and separation systems. Property included in asset class 49.5 has a class life of 10 years and, consequently, is classified as 7-year property under § 168(e)(1).

Section 5.05 of Rev. Proc. 87-56 states that asset guideline class 00.3, "Land Improvements," includes "other tangible property" that qualifies under § 1.48-1(d)(1). However, a structure that is essentially an item of machinery or equipment, or a structure that houses property used as an integral part of an activity specified in former § 48(a)(1)(B)(i) [including production] if the use of the structure is so closely related to the use of such property that the structure clearly can be expected to be replaced when the property it initially houses is replaced, is included in the asset guideline class appropriate to the equipment to which it is related. (In this regard, note also § 1.48-1(e)(1) for similar language regarding exceptions to the definition of building, which was discussed earlier.)

255

As discussed earlier, the Facility houses equipment that is used as an integral part of production and the use of the Facility is so closely related to the use of this equipment that the Facility clearly can be expected to be replaced when the equipment is replaced. Thus, the Facility is included in the asset class appropriate to the equipment to which it is related. Such asset class is asset class 49.5 of Rev. Proc. 87-56. Accordingly, the Facility has a class life of 10 years and, as a result, is classified as 7-year property under § 168(e)(1).

Conclusions

Based solely on the representations and relevant law and analysis as set forth above, we conclude that for purposes of § 168:

1. The Facility (exclusive of the equipment contained therein) is not a building within the meaning of § 1.48-1(e); and

2. The Facility (exclusive of the equipment contained therein) is included in asset class 49.5 of Rev. Proc. 87-56 and, as a result, is classified as 7-year property under § 168(e). Accordingly, if the Facility is depreciated in accordance with the general depreciation system of § 168(a), the applicable recovery period is 7 years under § 168(c).

Except as specifically ruled upon above, no opinion is expressed or implied regarding the application of any other provisions of the Code or regulations.

This letter ruling is directed only to the taxpayer who requested it. Section 6110(k)(3) provides that this ruling may not be used or cited as precedent. Temporary or final regulations pertaining to one or more of the issues addressed in this ruling have not yet been adopted. Therefore, this ruling may be revoked or modified by the adoption of temporary or final regulations to the extent the regulations are inconsistent with any conclusion in this ruling. See section 12.04 of Rev. Proc. 99-1, 1999-1 I.R.B. 6, 47. However, when criteria in section 12.05 of Rev. Proc. 99-1 are satisfied, a ruling is not revoked or modified retroactively, except in rare or unusual circumstances.

Taxpayer must attach a copy of this letter ruling to any federal tax return to which it is relevant. We enclose a copy for that purpose.

256

Pursuant to the power of attorney on file with this office, a copy of this letter ruling is being sent to the authorized legal representatives.

Sincerely yours,

KATHLEEN REED
Senior Technician Reviewer, Branch 6
Office of the Assistant Chief Counsel
(Passthroughs and Special Industries)

Enclosures (2):
6110 copy
copy of ruling

257