Office of Chief Counsel
Internal Revenue Service

Memorandum

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to: Associate Area Counsel (Denver)
(Large & Mid-Size Business)

from: Senior Technician Reviewer, Branch 6
(Passthroughs and Special Industries)

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subject: Request relating to proper asset classification of intermodal assets under Rev. Proc. 87-56

This Chief Counsel Advice responds to your request for assistance dated June 14, 2006. This advice may not be used or cited as precedent.

LEGEND

Taxpayer =
A =
B =
C =

ISSUES

1. Under which asset classes are Taxpayer's assets, used in Taxpayer's intermodal facilities and consisting of container handlers, load/unload ramps, straddle cranes, piggypacker side loaders, tire shredder passive and operative, truck scales, translift cranes, and crane pads, properly classified?

2. Under which asset classes are Taxpayer's assets, used in Taxpayer's intermodal facilities and consisting of (1) an administrative building, (2) a maintenance building, and (3) an office building, properly classified?

3. Under which asset classes are Taxpayer's assets, used in Taxpayer's intermodal facilities and consisting of fences; paving; sewer, lighting, outside wiring, road crossings; and computerized access gate, properly classified?

CONCLUSIONS

1. Taxpayer's assets, used in Taxpayer's intermodal facilities and consisting of container handlers, load/unload ramps, straddle cranes, piggypacker side loaders, tire shredder passive and operative, truck scales, translift cranes, and crane pads are classified in asset class 40.1 (Railroad Machinery and Equipment) of Rev. Proc. 87-56, 1987-2 C.B. 674, as clarified and modified by Rev. Proc. 88-22, 1988-1 C.B. 785.

2. Taxpayer's assets, used in Taxpayer's intermodal facilities and consisting of (1) an administrative building; (2) a maintenance building; and (3) an office building, are classified as nonresidential real property under section 168(e)(2)(B) having a statutorily-prescribed recovery period of 39 years under section 168(c).

3. Taxpayer's assets, used in Taxpayer's intermodal facilities and consisting of fences; paving; sewer, lighting, outside wiring, road crossings; and computerized access gate are classified in asset class 40.2 (Railroad Structures and Similar Improvements) of Rev. Proc. 87-56.

FACTS

The term "intermodal" refers to connections and coordination between different modes of transportation by road, rail, water, and/or air. Intermodal service is referred to as "TOFC/COFC service" in regulations issued by the Surface Transportation Board (STB),[1] U.S. Department of Transportation. 49 C.F.R. § 1090.1.

TOFC/COFC service is defined as:

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[1] The STB is a regulatory agency that Congress charged with the fundamental missions of resolving railroad rate and service disputes and reviewing proposed railroad mergers. The STB is decisionally independent, although it is administratively affiliated with the U.S. Department of Transportation. It was created in the Interstate Commerce Commission Termination Act of 1995 and is the successor agency to the Interstate Commerce Commission.

The STB has jurisdiction over railroad rate and service issues and rail restructuring transactions (mergers, line sales, line construction, and line abandonments); certain trucking company, moving van, and non-contiguous ocean shipping company rate matters; certain intercity passenger bus company structure, financial, and operational matters; and rates and services of certain pipelines not regulated by the Federal Energy Regulatory Commission.

(a) Rail trailer-on-flatcar/container-on-flatcar (TOFC/COFC) service means the transportation by rail, in interstate or foreign commerce, of--

(1) Any freight-laden highway truck, trailer, or semitrailer,

(2) The freight-laden container portion of any highway truck, trailer, or semitrailer having a demountable chassis,

(3) Any freight-laden multimodal vehicle designed to operate both as a highway truck, trailer, or semitrailer and as a rail car,

(4) Any freight-laden intermodal container comparable in dimensions to a highway truck, trailer, or semitrailer and designed to be transported by more than one mode of transportation, or

(5) Any of the foregoing types of equipment when empty and being transported incidental to its previous or subsequent use in TOFC/COFC service.

(b) Highway TOFC/COFC service means the highway transportation, in interstate or foreign commerce, of any of the types of equipment listed in paragraph (a) of this section as part of a continuous intermodal movement that includes rail TOFC/COFC service, and during which the trailer or container is not unloaded.

49 C.F.R. § 1090.1. [52 FR 23660, June 24, 1987]

“TOFC/COFC services are intermodal operations in which the various goods to be shipped are not handled individually.” Improvement of TOFC/COFC Regulations (Railroad-Affiliated Motor Carriers and Other Motor Carriers), 3 I.C.C. 2d 869, 871 (June 11, 1987). “Rather they are loaded (often by the shipper) into a trailer (for inland moves) or container (for inland/water moves) that can then be expeditiously transferred as a unit from one mode of transportation to another.” Id. “Under a typical COFC operation, for example, a container filled with one or more commodities may be transferred at a port from an ocean vessel to a railroad.” Id. The railroad then transports the container to an inland TOFC/COFC ramp.” Id. “There the railroad turns the container over either to a motor carrier or to one of its own trucks for delivery to the receiver or receivers.” Id.

Taxpayer is a railroad company and owns intermodal terminals that transfer freight in containerized cargoes from one mode of transportation to another, i.e., from trucks to railcars and vice versa. In response to growing demand for intermodal transport of freight via rail and truck, Taxpayer has built larger intermodal facilities capable of handling high volumes of intermodal shipments. These modern intermodal facilities include areas for railroad operations and truck terminal operations.

The portion of intermodal facilities related to railroad operations will generally include tracks for temporarily storing trains (storage support tracks), tracks for loading and unloading trains and truck trailers (loading tracks), tracks for accessing the loading and unloading areas (receiving and departure tracks), and tracks for sorting and assembling railcars into blocks of railcars for combination into trains (switch yard tracks).

The portion of intermodal facilities related to truck terminal operations typically includes equipment for moving containers from railcars to truck trailers; paved and/or black-topped areas sufficient to store a large number of intermodal containers; an automated gate entrance for sorting and routing trucks to the correct location within the facility upon arrival; administrative and maintenance buildings; lighting; security systems; and a truck repair shop. The administration building typically houses personnel operating the truck terminal portion of the intermodal facility, and sometimes is used to house personnel of other companies involved in the freight intermodal transportation network. Maintenance buildings, which are not accessible by rail, provide repair services for the truck trailers and the equipment used within the truck terminal portion of the intermodal facility.

For taxable years A and B, Taxpayer depreciated assets used in its intermodal facilities, including the assets used in the truck terminal portion of the intermodal facility, under asset class 40.1 (Railroad Machinery and Equipment) of Rev. Proc. 87-56 having a class life of 14 years with a recovery period of 7 years under section 168(c) of the Internal Revenue Code and asset class 40.2 (Railroad Structures and Similar Improvements) of Rev. Proc. 87-56 having a class life of 30 years with a recovery period of 20 years under section 168(c).

In C, Taxpayer filed a claim seeking a refund for years A and B based on its position that the truck terminal portion of its intermodal facilities should have been assigned to asset class 42.0 (Motor Transport-Freight) of Rev. Proc. 87-56. Asset class 42.0 includes assets used in the commercial and contract carrying of freight by road, and has a class life of 8 years with a recovery period of 5 years under section 168(c). According to Taxpayer's claim, recent case law has clarified that "[i]t is the nature of the use of a depreciable asset – not the primary business activity of the owner – which determines its proper classification for purposes of determining the time period over which it will be depreciated" citing Clajon Gas Co. v. Commissioner, 354 F.3d 786 (8th Cir. 2004), Saginaw Bay Pipeline Co. v. U.S., 338 F.3d 600 (6th Cir. 2003), and Duke Energy Natural Gas Corp. v. Commissioner, 172 F.3d 1255 (10th Cir. 1999). In its claim, Taxpayer states that the classification of the assets used in the truck terminal portion of the intermodal facility under asset class 42.0 is appropriate since the nature of these assets is more closely aligned with a trucking operation than a rail operation.

The assets at issue in this case are used in the truck terminal portion of the intermodal facility and are: machinery and equipment consisting of container handlers, load/unload ramps, straddle cranes, piggypacker side loaders, tire shredder passive and operative, truck scales, translift cranes, and crane pads; fences – these include interior fences located on the intermodal facility that surround machinery and trucks and includes fences that surround the intermodal facility; paving - paved and/or black-topped areas sufficient to store a large number of intermodal containers; sewer, lighting, outside wiring, and road crossings; computerized access gate - an automated gate entrance, used on the fences, for sorting and routing trucks to the correct location within the facility upon arrival; an administrative building that includes dispatch equipment, office space, conference room, file room, lunchroom, rest rooms, leased space for customer use, mechanical/electrical room, and telecommunications closet; an office building that is used as an office and houses personnel operating the truck terminal portion of the intermodal facility and that includes five office rooms, conference rooms, vending machines, lunch room, mechanical/electrical room, copy room, file room, supervisor office, and locker rooms; and a maintenance building that is not accessible by rail and is used for a truck repair garage, providing repair services for the truck trailers and the equipment used within the truck terminal.

Specifically, in its refund claim, Taxpayer has reclassified under asset class 42.0 (Motor Transport-Freight) of Rev. Proc. 87-56 the following assets located at its intermodal facility as follows:

(1) Administrative Building. Taxpayer originally classified these assets under asset class 40.2.

(2) Maintenance Building. Taxpayer originally classified these assets under asset class 40.2.

(3) Office Building. Taxpayer originally classified these assets under asset class 40.2.

(4) Fences. Taxpayer originally classified these assets under asset class 40.2.

(5) Paving. Taxpayer originally classified these assets under asset class 40.2.

(6) Sewer, lighting, outside wiring, road crossings. Taxpayer originally classified these assets under asset class 40.2.

(7) Container handlers. Taxpayer originally classified these assets under asset class 40.1.

(8) Load/unload ramps. Taxpayer originally classified these assets under asset class 40.1.

(9) Straddle cranes. Taxpayer originally classified these assets under asset class 40.1.

(10) Piggypacker side loaders. Taxpayer originally classified these assets under asset class 40.1.

(11) Tire shredder passive and operative. Taxpayer originally classified these assets under asset class 40.1.

(12) Truck scales. Taxpayer originally classified these assets under asset class 40.1.

(13) Translift cranes. Taxpayer originally classified these assets under asset class 40.1.

(14) Computerized access gate. Taxpayer originally classified these assets under asset class 40.2.

(15) Crane pad. Taxpayer originally classified these assets under asset class 40.1.

LAW AND ANALYSIS

Section 167(a) of the Internal Revenue Code provides a depreciation deduction of a reasonable allowance for the exhaustion, wear and tear, or obsolescence of property used in a trade or business or 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. The classification of depreciable property subject to section 168 is determined under section 168(e) by reference to class life or by statute. The applicable recovery period for purposes of the general depreciation system under section 168(a) or the alternative depreciation system under section 168(g) is keyed to the class life of the property. 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 had elected under that section. Prior to its revocation, section 167(m) provided that if a taxpayer elected the asset depreciation range system of depreciation, the depreciation deduction would be computed based on the class life prescribed by the Secretary that reasonably reflected 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 provides rules for classifying property under former section 167(m). Under these rules, property is included in the asset guideline class for the activity in which the property is primarily used and 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.

Section 1.167(a)-11(b)(4)(ii) states that asset classes are established in Rev. Proc. 72-10, 1972-1 C.B. 721, or its successors. Consistent with section 1.167(a)-11(b)(4)(iii)(b), which adopts the placing of assets into groups by primary activity of use, Rev. Proc. 72-10 established asset guideline classes based on business activity.

On January 1, 1971, the Interstate Commerce Commission (ICC)[2] created new accounts to reflect railroad investment in intermodal assets, i.e., ICC Accounts 25 (TOFC/COFC Terminals) and 55 (Highway Revenue Equipment). Rev. Proc. 73-23, 1973-2 C.B. 474, revised Rev. Proc. 72-10 to include the intermodal assets contained in ICC Account 25 (now STB account 25) in asset classes 40.1 (Railroad machinery and equipment) and 40.2 (Railroad structures and similar improvements). At the time that intermodal assets were included within asset classes 40.1 and 40.2, asset class 42.0 (Motor transport—freight) involving the carrying of freight by road was already in existence. See Rev. Proc. 72-10. Treasury considered grouping the assets in ICC account 25 under asset class 42.0. See Treasury's Office of Industrial Economics (OIE) report titled "A Study of Railroad Transportation Assets under the Class Life Asset Depreciation Range System for Modification of Revenue Procedure 72-10" (March 1973) (OIE Report). However, Treasury did not take this approach. Instead, as implemented in Rev. Proc. 73-23, Treasury concluded that the assets of TOFC/COFC terminals (i.e., ICC account 25) properly belong under the railroad transportation class.

The current successor to Rev. Proc. 72-10 is Rev. Proc. 87-56. This revenue procedure sets forth the class lives of property that are necessary to compute the depreciation allowances under section 168. Rev. Proc. 87-56 establishes two categories of depreciable assets: (1) asset classes 00.11 through 00.4, which consist of specific assets used in all business activities (asset categories); and (2) asset classes 01.1 through 80.0, which consist of assets used in specific business activities (activity categories) based on broadly defined industry classifications. The activity categories correspond to the industry classification described in the legislative history of former section 167(m). The same item of depreciable property may be described in both an asset category and an activity category, in which case the item is classified in the asset category unless specifically excluded from the asset category or specifically included in the activity category. See Norwest Corporation & Subsidiaries v. Commissioner, 111 T.C. 105 (1998) (item included in both an asset category and an activity category should be placed in the asset category).

The three different asset classes described in Rev. Proc. 87-56 at issue here are 40.1, 40.2, and 42.0.

For the years and assets in issue, Rev. Proc. 87-56 provides the following descriptions of depreciable assets used in the following activities:

> Railroad Transportation:
>
> Classes with the prefix 40 include the assets identified below that are used in the commercial and contract carrying of passengers and freight by rail. Assets of electrified railroads will be classified in a manner corresponding to that set forth below for railroads not independently operated as electric lines. Excludes the

[2] The ICC has been replaced by the Surface Transportation Board (STB).

assets included in classes with the prefix beginning 00.1 and 00.2 above, and also excludes any non-depreciable assets included in Interstate Commerce Commission accounts enumerated for this class.

Asset Class 40.1: Railroad Machinery and Equipment:
Includes assets, in pertinent part, classified in the following Interstate Commerce Commission accounts:

(25) TOFC/COFC terminals (freight handling machinery and equipment only). (Assets described in asset class 40.1 have a class life of 14 years and are depreciated over a recovery period of 7 years under the general depreciation system of section 168(a).)

Asset Class 40.2: Railroad Structures and Similar Improvements:
Includes assets, in pertinent part, classified in the following Interstate Commerce Commission accounts:

(25) TOFC/COFC terminals (operating structures only). (Assets described in asset class 40.2 have a class life of 30 years and are depreciated over a recovery period of 20 years under the general depreciation system of section 168(a).)

Asset Class 42.0: Motor Transport-Freight:
Includes assets used in the commercial and contract carrying of freight by road, except the transportation assets included in classes with the prefix 00.2. (Assets described in asset class 42.0 have a class life of 8 years and are depreciated over a recovery period of 5 years under the general depreciation system of section 168(a).)

Regulations governing ICC account 25 (now STB account 25) describe the account as follows:

25 TOFC/COFC terminals.

This account shall include the cost of structures, fixtures, machinery and appurtenances comprising terminals used for loading and unloading trailers and containers on and from flat cars.

TOFC/COFC TERMINAL STRUCTURES AND DETAILS

Cranes and hoists, including related machinery and appurtenances.
Drainage and sewerage.
Fences.
Grading and preparing grounds for TOFC/COFC terminals.
Offices, TOFC/COFC terminal.

Lighting system.
Platforms, ramps and appurtenances.
Power distribution systems.
Sidewalks, pavements and driveways on terminal grounds.
Terminal trucks and tractors.

Note A: "Trailer," as used in the text and elsewhere in this system of accounts unless otherwise indicated in the context, means trailer bodies used in TOFC/COFC service which are permanently mounted on running gear. "Containers" means trailer bodies used in TOFC/COFC service which are not permanently mounted on wheels or chassis, but are separated from such running gear before being loaded on flat cars.

Note B: The cost of grading and preparing grounds both before and after the construction of TOFC/COFC terminals, the cost of constructing sidewalks, driveways, and fences thereon, and the cost of permanent water rights shall be included in the cost of the buildings. The fees and expenses of architects employed to design or supervise the construction of the buildings shall also be included in the cost of the buildings. However, the cost of restoring the grounds after addition and betterment work shall be included in the appropriate operating expense accounts.

49 CFR Part 1201, Subpart A (10-1-87 Edition).

Thus, asset class 40.1 does not include all assets listed in ICC account 25 (now STB account 25), but is limited to freight handling machinery and equipment. ICC account 25 includes “the cost of ... machinery and appurtenances comprising terminals used for loading and unloading trailers and containers on and from flat cars.” Examples of freight handling machinery and equipment specifically listed in ICC account 25 that are classified in asset class 40.1 include cranes and hoists, including related machinery and appurtenances; ramps and appurtenances; and terminal trucks and tractors.

Further, asset class 40.2 does not include all assets listed in ICC account 25 (now STB account 25), but is limited to operating structures only. ICC account 25 includes “the cost of structures, fixtures . . . comprising terminals used for loading and unloading trailers and containers on and from flat cars.” Examples of such structures and fixtures specifically listed in ICC account 25 that are classified in asset class 40.2 include drainage and sewerage; fences; grading and preparing grounds for TOFC/COFC terminals; offices (TOFC/COFC terminals); lighting system; platforms, ramps (for example, a ramp attached to a platform) and appurtenances; power distribution systems; and sidewalks, pavements, and driveways on terminal grounds.

Asset class 42.0 includes assets used in the commercial and contract carrying of freight by road, except the transportation assets included in classes with the prefix 00.2. Asset classes that begin with the prefix 00.2 include (1) asset class 00.241 that includes trucks for use over the road (actual unloaded weight less than 13,000 pounds); (2) asset class 00.242 that includes trucks for use over the road (actual unloaded weight 13,000 pounds or more); (3) asset class 00.26 that includes tractor units for use over-the-road; and (4) asset class 00.27 that includes trailers and trailer-mounted containers. Thus, assets – other than the actual trucks, tractor units, trailers, and trailer-mounted containers themselves – used in the commercial and contract carrying of freight by road are included in asset class 42.0.[3]

Currently, Treasury has no authority to alter the class lives of existing assets or to create class lives for assets that are not described in Rev. Proc. 87-56. See section 168(i)(1). Prior to and for a short period of time after the enactment of the Tax Reform Act of 1986, the authority to set class lives rested with the Secretary of the Treasury. In the Tax Reform Act of 1986, Congress directed the Treasury Department to study the actual depreciation pattern of all depreciable assets, and granted the Department authority both to change class lives for assets with existing class lives and to prescribe class lives for assets that did not have any. See section 168(i)(1) as in effect on the day before the date of enactment of the Technical and Miscellaneous Revenue Act of 1988, 1988-3 C.B. 1 (1988). However, pursuant to section 6253 of the Technical and Miscellaneous Revenue Act of 1988, Treasury's authority to alter the class lives of existing assets or to create class lives for assets without any class lives was eliminated.

Taxpayer's position is that certain assets used at its intermodal facilities are used for trucking activities as opposed to railroad activities. Thus, Taxpayer believes that these assets are properly characterized under asset class 42.0 governing highway motor carrier activity as opposed to asset classes 40.1 and 40.2 governing railroad activity. Taxpayer further states that its identity as a railroad company is not relevant for purposes of properly classifying its intermodal assets.

Taxpayer points to the appellate decisions in Clajon Gas Co. v. Commissioner, 354 F.3d 786 (8th Cir. 2004), Saginaw Bay Pipeline Co. v. U.S., 338 F.3d 600 (6th Cir. 2003), and Duke Energy Natural Gas Corp. v. Commissioner, 172 F.3d 1255 (10th Cir. 1999). The central issue in these three cases was whether the taxpayer's natural gas gathering pipeline systems should be classified for tax purposes as production assets in asset class 13.2 (Exploration for and Production of Petroleum and Natural Gas Deposits)

[3] It should be noted that asset class 42.0 does not include section 1250 property. Section 1250 property is defined in section 1250(c) and includes buildings, as defined in section 1.48-1(e)(1). Thus, section 1250 property includes structures such as factory and office buildings, warehouses, and garages. See sections 1.1250-(1)(e)(3) and 1.1245-3(c)(2). The description of asset class 42.0 in Rev. Proc. 87-56 does not explicitly include section 1250 property. Thus, asset class 42.0 does not include buildings. In Walgreen Co. v. Commissioner, 103 T.C. 582 (1994), the Tax Court dealt with a similar issue involving whether another asset class description encompassed section 1250 property. The opinion closely followed the legislative and administrative history of the asset classes and class lives of section 1250 property. The Court found that Congress intended the asset class for section 1250 property to be explicitly prescribed, and not merely by inference, particularly in light of the difficulties the Service had experienced in establishing workable class lives for section 1250 property.

under Rev. Proc. 87-56 or as transportation assets in asset class 46.0 (Pipeline Transportation) under Rev. Proc. 87-56. Asset class 13.2 includes "assets used by petroleum and natural gas producers for drilling of wells and production of petroleum and natural gas, including gathering pipelines and related storage facilities." Asset class 46.0 includes "assets used in the private, commercial, and contract carrying of petroleum, gas and other products by means of pipes and conveyors."

In these three cases, the courts interpreted the "primary use" standard in section 1.167(a)-11(b)(4)(iii)(b) as being a use-driven functional standard for assigning asset classification. In Duke Energy, the 10th Circuit found the gathering systems are literally used by producers for gas production and the literal terms of the description of asset class 13.2 include any gathering system, as long as it is used by a gas producer. 172 F.3d at 1258-9.

Taxpayer's intermodal assets clearly fall within the literal descriptions of asset classes 40.1 and 40.2 of Rev. Proc. 87-56. Both asset classes specifically include assets classified in ICC account 25, TOFC/COFC terminals (now STB account 25, TOFC/COFC terminals). Asset class 40.1 includes the freight handling machinery and equipment in ICC account 25 and asset class 40.2 includes the operating structures in ICC account 25. Thus, the plain language of asset classes 40.1 and 40.2 of Rev. Proc. 87-56 includes Taxpayer's intermodal assets, both the rail portion and trucking portion.

Further, at the time that intermodal assets were included within asset classes 40.1 and 40.2, asset class 42.0 involving the carrying of freight by road was already in existence. See Rev. Proc. 72-10, 1972-1 C.B. 721. Treasury could have separated the "trucking portion" of intermodal terminals from the "rail portion" of intermodal terminals and included assets related to the trucking portion under asset class 42.0. This is what Taxpayer has asked for in its claim. However, Treasury did not take this approach. Moreover, TOFC/COFC transportation cannot be compartmentalized as either rail or motor transportation. See 3 I.C.C. 2d at 872.

Therefore, we must follow the classification of assets in ICC account 25 (now STB account 25) first implemented by Treasury in Rev. Proc. 73-23, 1973-2 C.B. 474, as superseded by Rev. Proc. 87-56. Assets used in the commercial and contract carrying of freight by rail described under asset classes 40.1 and 40.2 of Rev. Proc. 87-56 specifically include intermodal assets used at TOFC/COFC terminals, including even those assets that are similar to assets used by the trucking industry in carrying freight by road. This approach classifies Taxpayer's intermodal assets, both the rail portion and trucking portion of the assets, under asset classes 40.1 and 40.2.

Issues

Issue 1. Under which asset classes are Taxpayer's assets, used in Taxpayer's intermodal facilities and consisting of container handlers, load/unload ramps, straddle cranes, piggypacker side loaders, tire shredder passive and operative, truck scales, translift cranes, and crane pads, properly classified?

As stated above, asset class 40.1 (Railroad Machinery and Equipment) of Rev. Proc. 87-56 does not include all assets listed in ICC account 25 (now STB account 25), but only freight handling machinery and equipment used in conjunction with TOFC/COFC terminals. (In addition to machinery and equipment, ICC account 25 includes "structures" and "fixtures" used on TOFC/COFC terminals.) ICC account 25 includes machinery "comprising terminals used for loading and unloading trailers and containers on and from flat cars." Examples of such machinery specifically listed in ICC account 25 include cranes and hoists, including related machinery and appurtenances, and terminal trucks and tractors.

Taxpayer originally listed the following machinery and equipment used in conjunction with its TOFC/COFC terminal under asset class 40.1:

- Container handlers;
- Load/unload ramps;
- Straddle cranes;
- Piggypacker side loaders;
- Tire shredder passive and operative;
- Truck scales;
- Translift cranes; and
- Crane pad.

As discussed above, Taxpayer has taken the position that this machinery and equipment are properly classified under asset class 42.0 (Motor Transport-Freight) of Rev. Proc. 87-56 and should be depreciated over 5 years under the general depreciation system. Based on the foregoing discussions in our analysis relating to (1) the incorporation of the intermodal assets contained in ICC account 25 into asset class 40.1 and asset class 40.2 by Rev. Proc. 73-23 and (2) assets used in the commercial and contract carrying of freight by rail described under asset classes 40.1 and 40.2 of Rev. Proc. 87-56 include assets at intermodal terminals, the above items of machinery and equipment that Taxpayer originally listed under asset class 40.1 are properly classified in asset class 40.1 with a recovery period of 7 years under the general depreciation system.

<u>Issue 2</u>. Under which asset classes are Taxpayer's assets, used in Taxpayer's intermodal facilities and consisting of fences; paving; sewer, lighting, outside wiring, road crossings; and computerized access gate, properly classified? and

<u>Issue 3</u>. Under which asset classes are Taxpayer's assets, used in Taxpayer's intermodal facilities and consisting of (1) an administrative building; (2) a maintenance building that is used for a truck repair garage; and (3) an office building, properly classified?

As stated above, asset class 40.2 (Railroad Structures and Similar Improvements) of Rev. Proc. 87-56 does not include all assets listed in ICC account 25 (now STB account 25), but only operating structures used in conjunction with TOFC/COFC terminals. ICC account 25 includes “the cost of structures, fixtures . . . comprising terminals used for loading and unloading trailers and containers on and from flat cars.” Examples of such structures and fixtures specifically listed in ICC account 25 include drainage and sewerage, fences, offices (TOFC/COFC terminals), lighting system, platforms, power distribution systems, sidewalks, pavements, and driveways on terminal grounds.

Taxpayer originally listed the following structures located on its TOFC/COFC terminal under asset class 40.2:

- Administrative Building.
- Maintenance Building that is used for a truck repair garage.
- Office Building.
- Fences.
- Paving.
- Sewer, lighting, outside wiring, road crossings.
- Computerized Access Gate

Taxpayer has now taken the position that these structures are properly classified under asset class 42.0 (Motor Transport-Freight) and should be depreciated over 5 years under the general depreciation system.

The term “operating structure” under asset class 40.2 is not defined. As a starting point, under ICC regulation 49 C.F.R. § 1201.2-4 (10-1-87 Edition) (now STB regulation 49 C.F.R. § 1201.2-4) governing railroads, the term “structure” includes “buildings and facilities, including fixtures permanently attached to and made a part thereof.” However, note the discussion below under *Nonresidential Real Property*. Asset class 40.1 (Railroad Machinery and Equipment) includes the freight handling machinery and equipment category of intermodal assets of the ICC account 25 and asset class 40.2 (Railroad Structures and Similar Improvements) includes operating structures category of intermodal assets of the ICC account 25. ICC account 25 lists examples of these intermodal asset categories. Those assets listed that are not in the freight handling machinery and equipment category are in the operating structure category, which includes such land improvements as drainage and sewerage; fences; and sidewalks, pavements and driveways on the terminal grounds. In view of the foregoing discussion, the term “operating structures” in asset class 40.2 encompasses the fences, paving, sewer, lighting, outside wiring, road crossings, and computerized access gate. Therefore, these assets fall within asset class 40.2 and should be depreciated over 20 years under the general depreciation system. [4] [5]

Nonresidential Real Property

Although the buildings and other structures located on Taxpayer's intermodal facility would initially appear to be included in asset class 40.2, and therefore, have a recovery period of 20 years under the general depreciation system, this is not correct. Buildings and other structures located on Taxpayer's intermodal facility that fall under the definition of "nonresidential real property," as defined under section 168(e)(2)(B), have a statutory recovery period of 39 years under section 168(c) and 40 years under section 168(g).

Section 168(e)(2)(B) defines the term "nonresidential real property" as section 1250 property that is not residential rental property or property with a class life of less than 27.5 years. For purposes of the general depreciation system, section 168(c) provides that the applicable recovery period for nonresidential real property is 39 years for property placed in service after May 12, 1993, and 31.5 years for property placed in service after 1986 and before May 13, 1993.

Section 5.02 of Rev. Proc. 87-56 was clarified and modified by Rev. Proc. 88-22, 1988-1 C.B. 785 by adding the following paragraph at the end thereof:

> Under Section 168(e)(2)(B)(ii) of the Code, "nonresidential real property" does not include any property described in an asset class with a class life of less than 27.5 years. Even if nonresidential real property is described in an asset class with a class life of 27.5 years or more, the applicable recovery period for that property is 31.5 years for purposes of the general depreciation system and 40 years for purposes of the alternative depreciation system, regardless of the applicable recovery periods set out for the asset class in the tables below.

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[4] Note that it is recognized that fences are also described in asset class 00.3 (Land Improvements), an asset category. However, an asset that is included in both an asset category and an activity category is placed in the asset category unless it is specifically excluded from the asset category or specifically included in the activity category. Asset class 00.3 specifically excludes land improvements that are explicitly included in any other class. Asset class 40.2 is an activity category that specifically includes land improvements contained in ICC Account 25 that are considered "operating structures." Land improvements, such as fences located on terminal grounds, are specifically included within ICC Account 25. Because fences are specifically included in activity category 40.2, it falls within this asset class notwithstanding the fact that fences are also described in asset category 00.3.

[5] It should be noted that asset class 42.0 does not explicitly include land improvements. Consequently, asset class 42.0 does not include land improvements. Thus, if Taxpayer's position that asset class 42.0 is the proper activity class for its truck terminal operations at the intermodal facility is correct, the land improvements at issue are included in asset class 00.3 (Land Improvements), an asset category, and not asset class 42.0, an activity category.

Under Rev. Proc. 87-56, as clarified and modified by Rev. Proc. 88-22, the class life of assets that fall under asset class 40.2 is 30 years. Therefore, the assets that Taxpayer previously classified under asset class 40.2 that are properly characterized as nonresidential real property under section 168(e)(2)(B) have a statutorily-prescribed recovery period of 39 years under the general depreciation system and 40 years under the alternative depreciation system. Thus, the following assets listed in Taxpayer's claim should be depreciated under the general depreciation system over 39 years in accordance with section 168(c): (1) the administrative building, (2) the maintenance building, and (3) the office building. [6]

CASE DEVELOPMENT, HAZARDS AND OTHER CONSIDERATIONS

[redacted]

[redacted]
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[6] It should be noted that these same assets would be depreciated under the general depreciation system over 39 years if Taxpayer's position that asset class 42.0 is the proper activity class for its truck terminal operations at the intermodal facility is correct. The description of asset class 42.0 in Rev. Proc. 87-56 does not explicitly include section 1250 property. Thus, asset class 42.0 does not include buildings. See footnote 3