DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

OFFICE OF
CHIEF COUNSEL

September 8, 1999

Number: **199951005** UIL: 9999.98-00
Release Date: 12/23/1999
CC:DOM:FS:P&SI

MEMORANDUM FOR DISTRICT COUNSEL
ATTN:

FROM: ASSISTANT CHIEF COUNSEL
CC:DOM:FS

SUBJECT: RETIREMENTS / DEPRECIATION

This memorandum responds to your request for assistance in this docketed matter. This memorandum is not binding on Examination or Appeals and is not a final case determination. This document is not to be cited as precedent.

LEGEND:

T
Assets
Product
PLR
Agency
Date 1
Date 2
Date 3
Date 4
Date 5
Year 1
Year 2
Year 3
$1
$2

ISSUE:

Whether T’s sale of Assets is properly classified as a normal or abnormal retirement.

CONCLUSION:

We believe that the discovery information you have forwarded does not place our initial determination in question; we believe the sale of the Assets was an abnormal retirement pursuant to Treas. Reg. §§ 1.167 (a)-12(d)(2)(iii) and 1.167 (a)-12(d)(4).

FACTS:

T filed administrative claims for refund of federal income tax on Date 1, for the calendar Years 1 and 2 in the respective amounts of $1 plus statutory interest and $2 plus statutory interest. The Internal Revenue Service disallowed, in part, the claims for refund. T brought a claim for refund in the United States District Court on Date 2. The case is currently in discovery.

T was engaged primarily in the business of providing Product in Years 1 and 2 and prior years. Assets were furnished to customers as part of an integrated package of equipment and services. Agency ruled that after Date 3, T could not lease new Assets to customers but must offer them by sale through a new subsidiary and that Assets in place or in stock must eventually be offered for sale.

T requested a ruling from the Service allowing it to treat sales of previously leased Assets as normal retirements of property. The Service denied T's request in PLR on Date 4. Pursuant to PLR, T reported the gains from the sales of the Assets as taxable income on their returns for Years 1 and 2.

LAW AND ANALYSIS:

T argues that the sales of Assets were normal retirements under Honeywell, Inc. v. Commissioner, 87 T.C. 624 (1986), and that, as a result, its income was overstated in Years 1 and 2. It is T's position that the sales proceeds in Years 1 and 2 are to be credited to the depreciation reserve as salvage rather than included in income. This reduction in income would decrease tax liability and result in a refund due for those years. Credit of the proceeds to the depreciation reserve would result in a decrease in the depreciation deduction for Years 1 and 2; in addition, but for the statute of limitations, it would also result in a decrease in the allowable depreciation deduction for subsequent years.

As explained in the Field Service Advice dated Date 5, if the facts support a showing that the sale of the Assets resulted from a sudden, unanticipated Agency mandate and /or the withdrawal was outside the expected period of use, the sale would appear to be an abnormal retirement. Your office requested additional documentation from T to assist in the determination of whether the retirement was normal or abnormal. The documents your office recently forwarded to us are: a description of the T's method of depreciation and the quarterly accounting records used by T and its affiliates which detail assets added and retired from mass asset accounts. A comparison of similar assets cannot be made from these documents because these records do not make reference to the expected period of use of the assets without regard to class lives.

Furthermore, we cannot determine which assets may be similar to the Assets in issue. These documents do not establish that the sale of the Assets was a normal retirement. It appears that the permanent withdrawal of the Assets was due to an unanticipated event of the Agency mandate and that this unanticipated event was not taken into consideration in determining a depreciation rate.

CASE DEVELOPMENT, HAZARDS AND OTHER CONSIDERATIONS:

[redacted]

[redacted]

In addition to reducing T's income in Years 1 and 2, the treatment of the proceeds of the sale as a normal retirement of property and crediting the depreciation reserve in the amount of the proceeds would reduce allowable depreciation deductions in both Years 1 and 2 and subsequent years. This reduction of depreciation deductions would increase income tax liability in the affected subsequent years; however, assessment of any increased tax liability for the subsequent years is barred by the statute of limitations. I.R.C. § 6501(a).

[redacted].[1]

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[1] [redacted]

[redacted]

[redacted]

[redacted]

If you have any further questions, please call the branch telephone number.

DEBORAH A. BUTLER

By: ______________________________

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CHIEF, PASSTHROUGHS AND
SPECIAL INDUSTRIES BRANCH