

DEPARTMENT OF THE TREASURY**Internal Revenue Service****26 CFR Part 1**

[TD 9318]

RIN 1545-BE57

Guidance Regarding the Simplified Service Cost Method and the Simplified Production Method**AGENCY:** Internal Revenue Service (IRS), Treasury.**ACTION:** Final regulations and removal of temporary regulations.

SUMMARY: This document contains final regulations relating to the capitalization of costs under the simplified service cost method and the simplified production method provided by the Income Tax Regulations. For taxpayers that use the simplified service cost method or the simplified production method, the regulations clarify when self-constructed assets are produced on a routine and repetitive basis in the ordinary course of their businesses.

DATES: *Effective Date:* These regulations are effective on March 29, 2007.

Applicability Date: For dates of applicability, see §§ 1.263A-1(l) and 1.263A-2(f).

FOR FURTHER INFORMATION CONTACT: Steven J. Gee or Donna M. Crawford, (202) 622-4970 (not a toll-free number).

SUPPLEMENTARY INFORMATION:**Background**

This document contains amendments to 26 CFR part 1. On August 2, 2005, the IRS and Treasury Department published in the **Federal Register** a notice of proposed rulemaking (REG-121584-05; 70 FR 44535) by cross reference to temporary regulations (TD 9217; 70 FR 44467) (collectively, the 2005 regulations) under section 263A of the Internal Revenue Code (Code). These regulations provide that self-constructed tangible personal property is considered produced on a routine and repetitive basis in the ordinary course of a taxpayer's trade or business for purposes of the simplified service cost method or the simplified production method when units of tangible personal property are mass-produced, that is, numerous substantially identical assets are manufactured within a taxable year using standardized designs and assembly line techniques, and the applicable recovery period of such assets under section 168(c) is not longer than 3 years.

The IRS and Treasury Department issued Rev. Proc. 2006-11 (2006-3 IRB

309), see § 601.601(d)(2)(ii)(b), which provides procedures by which a taxpayer changing its method of accounting to comply with § 1.263A-1T or § 1.263A-2T (issued under TD 9217) for its first taxable year ending on or after August 2, 2005, may request the consent of the Commissioner utilizing either the administrative procedures for requesting the advance consent of the Commissioner (for further guidance, for example, see Rev. Proc. 97-27 (1997-1 CB 680), as modified and amplified by Rev. Proc. 2002-19 (2002-1 CB 696), as amplified and clarified by Rev. Proc. 2002-54 (2002-2 CB 432), and § 601.601(d)(2)(ii)(b)), or the administrative procedures for obtaining the automatic consent of the Commissioner (for further guidance, for example, see Rev. Proc. 2002-9 (2002-1 CB 327), as modified and clarified by Announcement 2002-17 (2002-1 CB 561), modified and amplified by Rev. Proc. 2002-19 (2002-1 CB 696), and amplified, clarified, and modified by Rev. Proc. 2002-54 (2002-2 CB 432), and § 601.601(d)(2)(ii)(b)). These final regulations have been revised to be consistent with the procedures provided in Rev. Proc. 2006-11.

One written comment was received in response to the 2005 regulations. No requests to speak at a public hearing were received, and no hearing was held. After consideration of the comment, the proposed regulations under section 263A are adopted by this Treasury decision.

Summary of Comments

A commentator expressed the belief that the categories of property, as described in Notice 88-86 (1988-2 CB 401), see § 601.601(d)(2)(ii)(b), eligible for the simplified service cost method and the simplified production method represent a reasonable balance between technical accuracy and simplification. The commentator opposed the requirements in the 2005 regulations that, to qualify for the category of property "produced on a routine and repetitive basis," the property must be mass-produced using standardized designs and assembly line techniques, and have an applicable recovery period of not longer than 3 years. The commentator argued that, with respect to electric utility companies, there is no sound tax policy to support limiting the application of the methods based on the manner in which self-constructed assets are produced or the number of years over which the self-constructed assets are depreciated. The commentator further stated that the preamble to the 2005 regulations did not explain why there may be a distortion of income

from the use of the simplified methods, and why such a distortion justified distinctions based on the method of manufacturing and the recovery lives of property.

The simplified methods are less accurate and less precise than a facts and circumstances method and, thus, may capitalize more or less costs than a facts and circumstances method. Therefore, the simplified methods may cause distortions when compared to a more accurate facts and circumstances method. The amount of distortion may not be very large for assets that are mass produced, because the underlying assumption of the simplified methods that costs are incurred ratably across all the assets may be appropriate. Additionally, any distortion caused by the lack of precision quickly reverses if the assets to which the methods may be applied typically have a high turnover rate, that is, a short recovery period. Inventory production frequently meets one or both of these two criteria. The IRS and Treasury Department provided the simplified methods for inventory because the reduction in the burdens of complying with the uniform capitalization rules generally outweighed the possible distortion within the simplified methods.

Under temporary regulations published in the **Federal Register** on March 30, 1987 (TD 8131, 1987-1 CB 98, [52 FR 10052]) (1987 regulations), the simplified methods were available only to inventory and non-inventory property held by a taxpayer primarily for sale to customers in the ordinary course of the taxpayer's trade or business. The preamble to the 1987 regulations stated that the methods were "designed to alleviate the administrative burdens of complying with [section 263A] where mass production of assets occurs on a repetitive and routine basis, with a typically high 'turnover' rate for the produced assets." The preamble to the 1987 regulations stated that the simplified methods could not be utilized with respect to self-constructed assets because the simplified methods were not appropriate for use "in accounting for casual or occasional production of property."

In response to comments suggesting that the categories of property eligible for the simplified service cost method and the simplified production method be expanded to include other categories of property with similar characteristics, Notice 88-86 expanded the availability of the methods, in relevant part, to "property constructed by a taxpayer for use in its trade or business if, in the ordinary course of its production activities, the taxpayer produces such

property on a routine and repetitive basis (that is, the taxpayer produces numerous items of such property within a taxable year)." The final regulations published in the **Federal Register** on August 9, 1993 (TD 8482, 1993-2 CB 77, [58 FR 42198]) included the new category from Notice 88-86. The addition of certain self-constructed assets was merely intended to add another category of property with characteristics similar to inventory (mass produced or high turnover) and was not an indication that the application of the simplified methods to the production, whether or not casual or occasional, of all self-produced assets was considered appropriate.

The IRS and Treasury Department continue to believe that to prevent distortion when applied to self-constructed property, the simplified service cost method and simplified production method should be limited to property that is mass produced and has a typically high "turnover" rate. Accordingly, the final regulations do not incorporate the commentator's suggestions. The regulations clarify, however, that property with a typically high "turnover" rate includes materials and supplies that are used and consumed within three years of being produced.

The IRS and Treasury Department recognize that the application of the uniform capitalization requirements to self-constructed property can be burdensome, particularly to small taxpayers. The IRS and Treasury Department will consider proposing simplified methods for self-constructed property for small taxpayers in future guidance under section 263A.

Additionally, a commentator indicated that for taxpayers that have both property that is eligible for the simplified methods and property that is ineligible for the simplified methods, the regulations do not provide specific procedures to determine how to allocate service costs and other indirect costs between the eligible property and the ineligible property. The IRS and Treasury Department agree that service costs and other indirect costs must be allocated to ineligible property as well as eligible property. However, prescribing specific procedures and methods for these allocations is beyond the scope of these regulations. The IRS and Treasury Department may address this issue in future guidance.

Special Analyses

It has been determined that this Treasury decision is not a significant regulatory action as defined in Executive Order 12866. Therefore, a

regulatory assessment is not required. It also has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations, and because the regulations do not impose a collection of information on small entities, the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply. Pursuant to section 7805(f) of the Code, the notice of proposed rulemaking that preceded these regulations was submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

Drafting Information

The principal author of these regulations is Scott Rabinowitz of the Office of Associate Chief Counsel (Income Tax and Accounting). However, other personnel from the IRS and Treasury Department participated in their development.

List of Subjects in 26 CFR Part 1

Income taxes, Reporting and recordkeeping requirements.

Adoption of Amendments to the Regulations

■ Accordingly, 26 CFR part 1 is amended as follows:

PART 1—INCOME TAXES

■ **Paragraph 1.** The authority citation for part 1 continues to read in part as follows:

Authority: 26 U.S.C. 7805 * * *

■ **Par. 2.** Section 1.263A-1 is amended by revising paragraphs (h)(2)(i)(D), (k) and (l) to read as follows:

§ 1.263A-1 Uniform capitalization of costs.

* * * * *

(h) * * *
(2) * * *
(i) * * *

(D) *Self-constructed tangible personal property produced on a routine and repetitive basis—(1) In general.* Self-constructed tangible personal property produced by the taxpayer on a routine and repetitive basis in the ordinary course of the taxpayer's trade or business. Self-constructed tangible personal property is produced by the taxpayer on a routine and repetitive basis in the ordinary course of the taxpayer's trade or business when units of tangible personal property (as defined in § 1.263A-10(c)) are mass-produced, that is, numerous substantially identical assets are manufactured within a taxable year using standardized designs and assembly line techniques, and either the applicable recovery period of the property determined under section

168(c) is not longer than 3 years or the property is a material or supply that will be used and consumed within 3 years of being produced. For purposes of this paragraph (h)(2)(i)(D), the applicable recovery period of the assets will be determined at the end of the taxable year in which the assets are placed in service for purposes of § 1.46-3(d). Subsequent changes to the applicable recovery period after the assets are placed in service will not affect the determination of whether the assets are produced on a routine and repetitive basis for purposes of this paragraph (h)(2)(i)(D).

(2) *Examples.* The following examples illustrate this paragraph (h)(2)(i)(D):

Example 1. Y is a manufacturer of automobiles. During the taxable year Y produces numerous substantially identical dies and molds using standardized designs and assembly line techniques. The dies and molds have a 3-year applicable recovery period for purposes of section 168(c). Y uses the dies and molds to produce or process particular automobile components and does not hold them for sale. The dies and molds are produced on a routine and repetitive basis in the ordinary course of Y's business for purposes of this paragraph because the dies and molds are both mass-produced and have a recovery period of not longer than 3 years.

Example 2. Z is an electric utility that regularly manufactures and installs identical poles that are used in transmitting and distributing electricity. The poles have a 20-year applicable recovery period for purposes of section 168(c). The poles are not produced on a routine and repetitive basis in the ordinary course of Z's business for purposes of this paragraph because the poles have an applicable recovery period that is longer than 3 years.

* * * * *

(k) *Change in method of accounting—(1) In general.* A change in a taxpayer's treatment of mixed service costs to comply with paragraph (h)(2)(i)(D) of this section is a change in method of accounting to which the provisions of sections 446 and 481 and the regulations under those sections apply. See § 1.263A-7. For a taxpayer's first taxable year ending on or after August 2, 2005, the taxpayer is granted the consent of the Commissioner to change its method of accounting to comply with paragraph (h)(2)(i)(D) of this section, provided the taxpayer follows the administrative procedures, as modified by paragraphs (k)(2) through (4) of this section, issued under § 1.446-1(e)(3)(ii) for obtaining the Commissioner's automatic consent to a change in accounting method (for further guidance, for example, see Rev. Proc. 2002-9 (2002-1 CB 327), as modified and clarified by Announcement 2002-17 (2002-1 CB 561), modified and

amplified by Rev. Proc. 2002-19 (2002-1 CB 696), and amplified, clarified, and modified by Rev. Proc. 2002-54 (2002-2 CB 432), and § 601.601(d)(2)(ii)(b) of this chapter). For purposes of Form 3115, "Application for Change in Accounting Method," the designated number for the automatic accounting method change authorized by this paragraph (k) is "95." If Form 3115 is revised or renumbered, any reference in this section to that form is treated as a reference to the revised or renumbered form. Alternatively, notwithstanding the provisions of any administrative procedures that preclude a taxpayer from requesting the advance consent of the Commissioner to change a method of accounting that is required to be made pursuant to a published automatic change procedure, for its first taxable year ending on or after August 2, 2005, a taxpayer may request the advance consent of the Commissioner to change its method of accounting to comply with paragraph (h)(2)(i)(D) of this section, provided the taxpayer follows the administrative procedures, as modified by paragraphs (k)(2) through (5) of this section, for obtaining the advance consent of the Commissioner (for further guidance, for example, see Rev. Proc. 97-27 (1997-1 CB 680), as modified and amplified by Rev. Proc. 2002-19 (2002-1 CB 696), as amplified and clarified by Rev. Proc. 2002-54 (2002-2 CB 432), and § 601.601(d)(2)(ii)(b) of this chapter). For the taxpayer's second and subsequent taxable years ending on or after August 2, 2005, requests to secure the consent of the Commissioner must be made under the administrative procedures, as modified by paragraphs (k)(3) and (4) of this section, for obtaining the Commissioner's advance consent to a change in accounting method.

(2) *Scope limitations.* Any limitations on obtaining the automatic consent or advance consent of the Commissioner do not apply to a taxpayer seeking to change its method of accounting to comply with paragraph (h)(2)(i)(D) of this section for its first taxable year ending on or after August 2, 2005.

(3) *Audit protection.* A taxpayer that changes its method of accounting in accordance with this paragraph (k) to comply with paragraph (h)(2)(i)(D) of this section does not receive audit protection if its method of accounting for mixed service costs is an issue under consideration at the time the application is filed with the national office.

(4) *Section 481(a) adjustment.* A change in method of accounting to conform to paragraph (h)(2)(i)(D) of this section requires a section 481(a) adjustment. The section 481(a)

adjustment period is two taxable years for a net positive adjustment for an accounting method change that is made to conform to paragraph (h)(2)(i)(D) of this section.

(5) *Time for requesting change.* Notwithstanding the provisions of § 1.446-1(e)(3)(i) and any contrary administrative procedure, a taxpayer may submit a request for advance consent to change its method of accounting to comply with paragraph (h)(2)(i)(D) of this section for its first taxable year ending on or after August 2, 2005, on or before the date that is 30 days after the end of the taxable year for which the change is requested.

(l) *Effective date.* Paragraphs (h)(2)(i)(D), (k), and (l) of this section apply for taxable years ending on or after August 2, 2005.

§ 1.263A-1T [Removed]

■ **Par. 3.** Section 1.263A-1T is removed.

■ **Par. 4.** Section 1.263A-2 is amended by revising paragraphs (b)(2)(i)(D), (e) and (f) to read as follows:

§ 1.263A-2 Rules relating to property produced by the taxpayer.

* * * * *

(b) * * *

(2) * * *

(i) * * *

(D) *Self-constructed tangible personal property produced on a routine and repetitive basis—(1) In general.* Self-constructed tangible personal property produced by the taxpayer on a routine and repetitive basis in the ordinary course of the taxpayer's trade or business. Self-constructed tangible personal property is produced by the taxpayer on a routine and repetitive basis in the ordinary course of the taxpayer's trade or business when units of tangible personal property (as defined in § 1.263A-10(c)) are mass-produced, that is, numerous substantially identical assets are manufactured within a taxable year using standardized designs and assembly line techniques, and either the applicable recovery period of the property determined under section 168(c) is not longer than 3 years or the property is a material or supply that will be used and consumed within 3 years of being produced. For purposes of this paragraph (b)(2)(i)(D), the applicable recovery period of the assets will be determined at the end of the taxable year in which the assets are placed in service for purposes of § 1.46-3(d). Subsequent changes to the applicable recovery period after the assets are placed in service will not affect the determination of whether the assets are produced on a routine and repetitive

basis for purposes of this paragraph (b)(2)(i)(D).

(2) *Examples.* The following examples illustrate this paragraph (b)(2)(i)(D):

Example 1. Y is a manufacturer of automobiles. During the taxable year Y produces numerous substantially identical dies and molds using standardized designs and assembly line techniques. The dies and molds have a 3-year applicable recovery period for purposes of section 168(c). Y uses the dies and molds to produce or process particular automobile components and does not hold them for sale. The dies and molds are produced on a routine and repetitive basis in the ordinary course of Y's business for purposes of this paragraph because the dies and molds are both mass-produced and have a recovery period of not longer than 3 years.

Example 2. Z is an electric utility that regularly manufactures and installs identical poles that are used in transmitting and distributing electricity. The poles have a 20-year applicable recovery period for purposes of section 168(c). The poles are not produced on a routine and repetitive basis in the ordinary course of Z's business for purposes of this paragraph because the poles have an applicable recovery period that is longer than 3 years.

* * * * *

(e) *Change in method of accounting—(1) In general.* A change in a taxpayer's treatment of additional section 263A costs to comply with paragraph (b)(2)(i)(D) of this section is a change in method of accounting to which the provisions of sections 446 and 481 and the regulations under those sections apply. See § 1.263A-7. For a taxpayer's first taxable year ending on or after August 2, 2005, the taxpayer is granted the consent of the Commissioner to change its method of accounting to comply with paragraph (b)(2)(i)(D) of this section, provided the taxpayer follows the administrative procedures, as modified by paragraphs (e)(2) through (4) of this section, issued under § 1.446-1(e)(3)(ii) for obtaining the Commissioner's automatic consent to a change in accounting method (for further guidance, for example, see Rev. Proc. 2002-9 (2002-1 CB 327), as modified and clarified by Announcement 2002-17 (2002-1 CB 561), modified and amplified by Rev. Proc. 2002-19 (2002-1 CB 696), and amplified, clarified, and modified by Rev. Proc. 2002-54 (2002-2 CB 432), and § 601.601(d)(2)(ii)(b) of this chapter). For purposes of Form 3115, "Application for Change in Accounting Method," the designated number for the automatic accounting method change authorized by this paragraph (e) is "95." If Form 3115 is revised or renumbered, any reference in this section to that form is treated as a reference to the revised or renumbered form. Alternatively,

notwithstanding the provisions of any administrative procedures that preclude a taxpayer from requesting the advance consent of the Commissioner to change a method of accounting that is required to be made pursuant to a published automatic change procedure, for its first taxable year ending on or after August 2, 2005, a taxpayer may request the advance consent of the Commissioner to change its method of accounting to comply with paragraph (b)(2)(i)(D) of this section, provided the taxpayer follows the administrative procedures, as modified by paragraphs (e)(2) through (5) of this section, for obtaining the advance consent of the Commissioner (for further guidance, for example, see Rev. Proc. 97-27 (1997-1 CB 680), as modified and amplified by Rev. Proc. 2002-19 (2002-1 CB 696), as amplified and clarified by Rev. Proc. 2002-54 (2002-2 CB 432), and § 601.601(d)(2)(ii)(b) of this chapter). For the taxpayer's second and subsequent taxable years ending on or after August 2, 2005, requests to secure the consent of the Commissioner must be made under the administrative procedures, as modified by paragraphs (e)(3) and (4) of this section, for obtaining the Commissioner's advance consent to a change in accounting method.

(2) *Scope limitations.* Any limitations on obtaining the automatic consent or advance consent of the Commissioner do not apply to a taxpayer seeking to change its method of accounting to comply with paragraph (b)(2)(i)(D) of this section for its first taxable year ending on or after August 2, 2005.

(3) *Audit protection.* A taxpayer that changes its method of accounting in accordance with this paragraph (e) to comply with paragraph (b)(2)(i)(D) of this section does not receive audit protection if its method of accounting for additional section 263A costs is an issue under consideration at the time the application is filed with the national office.

(4) *Section 481(a) adjustment.* A change in method of accounting to conform to paragraph (b)(2)(i)(D) of this section requires a section 481(a) adjustment. The section 481(a) adjustment period is two taxable years for a net positive adjustment for an accounting method change that is made to conform to paragraph (b)(2)(i)(D) of this section.

(5) *Time for requesting change.* Notwithstanding the provisions of § 1.446-1(e)(3)(i) and any contrary administrative procedure, a taxpayer may submit a request for advance consent to change its method of accounting to comply with paragraph

(b)(2)(i)(D) of this section for its first taxable year ending on or after August 2, 2005, on or before the date that is 30 days after the end of the taxable year for which the change is requested.

(f) *Effective date.* Paragraphs (b)(2)(i)(D), (e), and (f) of this section apply for taxable years ending on or after August 2, 2005.

§ 1.263A-2T [Removed]

■ **Par. 5.** Section 1.263A-2T is removed.

Kevin M. Brown,

Deputy Commissioner for Services and Enforcement.

Approved: March 20, 2007.

Eric Solomon,

Assistant Secretary of the Treasury (Tax Policy).

[FR Doc. E7-5732 Filed 3-28-07; 8:45 am]

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DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Part 1

[TD 9313]

RIN 1545-BG29

Corporate Reorganizations; Additional Guidance on Distributions Under Sections 368(a)(1)(D) and 354(b)(1)(B); Correction

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Correcting amendment.

SUMMARY: This document contains correction to temporary regulations (TD 9313) that were published in the **Federal Register** on Thursday, March 1, 2007 (72 FR 9262) providing guidance regarding the qualification of certain transactions as reorganizations described in section 368(a)(1)(D) where no stock and/or securities of the acquiring corporation are issued and distributed in the transaction.

DATES: This amendment is effective March 29, 2007.

FOR FURTHER INFORMATION CONTACT: Bruce A. Decker at (202) 622-7550 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background

The temporary regulations that are the subjects of this correction are under section 368 of the Internal Revenue Code.

Need for Correction

As published, temporary regulations (TD 9313) contain an error that may

prove to be misleading and is in need of clarification.

List of Subjects in 26 CFR Part 1

Income taxes, Reporting and recordkeeping requirements.

Correction of Publication

■ Accordingly, 26 CFR part 1 is corrected by making the following amendments:

PART 1—INCOME TAXES

■ **Paragraph 1.** The authority citation for part 1 continues to read, in part, as follows:

Authority: 26 U.S.C. 7805 * * *

■ **Par. 2.** Section 1.368-2T is amended by revising paragraph (l)(2)(iv) to read as follows:

§ 1.368-2T Definition of terms (temporary).

* * * * *

(1) * * *

(2) * * *

(iv) *Exception.* This paragraph (l)(2) of this section does not apply to a transaction otherwise described in § 1.358-6(b)(2) or section 368(a)(1)(G) by reason of section 368(a)(2)(D).

* * * * *

LaNita Van Dyke,

Chief, Publications and Regulations Branch, Legal Processing Division, Associate Chief Counsel, (Procedure and Administration).

[FR Doc. E7-5603 Filed 3-28-07; 8:45 am]

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ENVIRONMENTAL PROTECTION AGENCY

40 CFR Part 52

[EPA-R05-OAR-2006-0774; FRL-8284-5]

Approval and Promulgation of Air Quality Implementation Plans; Indiana

AGENCY: Environmental Protection Agency (EPA).

ACTION: Direct final rule.

SUMMARY: The EPA is approving revisions to Indiana's State Implementation Plan (SIP) submitted on August 25, 2006, revising its existing emission reporting rule to be consistent with the emission statement program requirements for stationary sources in the Clean Air Act (CAA). The rationale for approval and other information are provided in this rulemaking action.

DATES: This direct final rule will be effective May 29, 2007, unless EPA receives adverse comments by April 30, 2007. If adverse comments are received, EPA will publish a timely withdrawal of