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INTERNAL REVENUE SERVICE
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INTERNAL REVENUE SERVICE NATIONAL OFFICE FIELD SERVICE ADVICE

MEMORANDUM FOR ASSOCIATE AREA COUNSEL
CC:LM:MCT:CLE:PIT

FROM: PAUL F. KUGLER
ASSOCIATE CHIEF COUNSEL
CC:PSI

SUBJECT:

This Chief Counsel Advice responds to your memorandum dated April 12, 2001. In accordance with I.R.C. § 6110(k)(3), this Chief Counsel Advice should not be cited as precedent.

LEGEND

A =
B =
C =
D =
E =
F =
G =
Date1 =
Date2 =
Date3 =
Date4 =
Date5 =
$X =
$Y =

ISSUE

Whether A can claim a loss deduction for the difference between the written down fair market value and the adjusted basis of a facility in tax year Date3 when it closed the facility, or in tax year Date5 when it actually sold the facility.

CONCLUSION

A cannot claim a loss deduction for the facility in tax year Date3 when it closed the facility because A did not retire or otherwise permanently withdraw the property within the meaning of the applicable regulations under section 167 and the proposed regulations under former section 168. As such, A is entitled to take depreciation deductions on the facility for tax year Date3 through tax year Date5 when A actually sold the facility.

FACTS

In Date1, C acquired two floors in a ten-story business condominium building in B. It used the floors to house its computer operations. This property is referred to as the “facility.”

In Date2, A acquired C. Sometime soon after the acquisition, A’s management decided to close C’s computer operations in B because it was a duplication of A’s existing computer operations in D. As a result, C hired the E to give assistance in disposing of the facility. E did an analysis and concluded that there was an overcapacity of computer centers of this type and placed a fair market value on the facility below the facility’s adjusted basis.

On Date 4, the facility was vacated and its personnel were either transferred or fired. The computer equipment was sold to F and G. A retained a broker to sell the facility. A wrote down the value of the property to $X, which was the value determined by the broker. The write down resulted in a tax loss of $Y and an adjusted tax basis of $X on A’s tax records. The facility was vacant until it was eventually sold in Date5 to the other tenant in the building who had occupied the other floors.

The facility, which was placed in service in Date1, had been depreciated in a single asset account under the Modified Cost Recovery System (MACRS) of section 168 of the Internal Revenue Code (which is generally applicable to property placed in service after 1986) as nonresidential property subject to a recovery period of 31.5 years. For tax purposes, C did not claim depreciation deductions after the facility was vacated on Date4. For book purposes, C wrote down the facility at the end of Date2, but continued to depreciate the facility (using the lower written-down adjusted book basis) until the facility was disposed of in Date5.

The amount of the loss is not in dispute. The timing of the loss is. This case is currently in nondocketed status.

LAW AND ANALYSIS

Section 165(a) provides that there shall be allowed as a deduction any loss sustained during the taxable year and not compensated for by insurance or otherwise. Section 1.165-2(c) of the Income Tax Regulations cross-references section 1.167(a)-8 for determining the allowance of section 165(a) losses arising from the permanent withdrawal of depreciable property from use in the trade or business or in the production of income.

No regulations under section 168 apply to the retirement of MACRS assets in single asset accounts, such as the facility in issue. In the absence of applicable MACRS regulations, we have looked to section 1.167(a)-8(a), as cross-referenced under section 165(a), and to the proposed regulations under former section 168 (which generally applied to property placed in service after 1980 and before 1987), the Accelerated Cost Recovery System (ACRS), and other sources, for guidance.

Section 1.167(a)-8(a) addresses gains and losses on retirement. It provides that the term “retirement” means the permanent withdrawal of depreciable property from use in the trade or business or in the production of income. The withdrawal may be made in one of several ways. For example, the withdrawal may be made by selling or exchanging the asset, or by actual abandonment. In addition, the asset may be withdrawn from productive use without disposition as, for example, by being placed in a supplies or scrap account.

Section 1.167(a)-8(a)(3) provides that where an asset is permanently retired from use in the trade or business or in the production of income, but is not disposed of by the taxpayer or physically abandoned (e.g., when the asset is transferred to a supplies or scrap account), loss will be recognized, but only if the retirement is an abnormal retirement, a normal retirement from a single asset account, or a normal retirement from a multiple asset account under certain circumstances.

Section 1.167(a)-8(a)(4) provides, in part, that in order to qualify for the recognition of loss from physical abandonment, the intent of the taxpayer must be irrevocably to discard the asset so that it will neither be used again by him nor retrieved by him for sale, exchange, or other disposition. Similar rules for gain or loss on the retirement of assets subject to ACRS are provided by section 1.168-6(a)(3) of the Proposed Income Tax Regulations. MACRS and ACRS are different in many respects but no material difference exists for dispositions or retirements from single asset accounts. Thus, the proposed ACRS regulations are instructive on the treatment of retirements.

Proposed section 1.168-6 provides in relevant part:

(a) . . . Where recovery property is disposed of during a taxable year, the following rules shall apply:

(1) If the asset is disposed of by sale or exchange, gain or loss shall be recognized as provided under the applicable provisions of the Code . . . .

(3) If the asset is disposed of other than by sale or exchange or physical abandonment (as, for example, where the asset is transferred to a supplies or scrap account), gain shall not be recognized. Loss shall be recognized in the amount of the excess of the adjusted basis of the asset over its fair market value at the time of the disposition. No loss shall be recognized upon the conversion of property to personal use.

(b) Definitions. (1) See section 1.168-2(l)(1) for the definition of "disposition," which excludes the retirement of a structural component of 15-year real property.

Section 1.168-2(l)(1) provides that (for purposes of section 168 and sections 1.168-1 through 1.168-6(1)) the term "disposition" means the permanent withdrawal of property from use in the taxpayer's trade or business or use for the production of income. Withdrawal may be made in several ways, including sale, exchange, retirement, abandonment, or destruction. A disposition does not include a transfer of property by gift or by reason of the death of the taxpayer . . . . The manner of disposition (e.g., normal retirement, abnormal retirement) is not a consideration.

A did not sell or exchange the facility in Date3, the tax year in which A is claiming the disposition or retirement loss of the facility for tax purposes. Also, since A sold the facility in Date5, A did not abandon the facility in Date3 because abandonment implies that a taxpayer irrevocably discard an asset so that it cannot be retrieved for sale or exchange.

Thus, A's only remaining recourse to claim a loss in tax year Date3 is arguing that the disposition or withdrawal of the facility was made by retirement. The examples of retirement in the regulations are by transfers to a supplies or scrap account; these regulations contemplate that at the time of a retirement the property will have only nominal value. Here, the facility had significant value when vacated. Because the facility had much more than a nominal value and this value represented a significant portion of A's basis in the property, the facility was not retired within the meaning of the regulations.

CASE DEVELOPMENT, HAZARDS AND OTHER CONSIDERATIONS

[redacted]

[redacted] Although there is no case law authority directly on point, we should emphasize that section 1.167(a)-8(b) provides that the determination whether a retirement is normal or abnormal is made on a facts and circumstances basis. A retirement is considered abnormal if the asset is withdrawn at an earlier time than when the asset is normally withdrawn. Generally, this means that the asset was withdrawn at a time earlier than the range of years[1] taken into consideration in fixing the depreciation rate for the asset and before the asset reached a condition at which, in the normal course of events, the taxpayer customarily retires similar assets from use in the taxpayer's business. For example, a retirement is considered abnormal if the asset is withdrawn at an earlier time than the end of its estimated useful life. Estate of Walter P. Myers v. Commissioner, T.C. Memo. 1981-384. As such, A can argue that the facility was retired at an earlier time than when the asset is normally withdrawn because it was withdrawn substantially before the end of its recovery period.

Abnormal retirement can also occur under other circumstances, as, for example, when the asset has been damaged by casualty or has lost its usefulness suddenly as the result of extraordinary obsolescence.

Soon after A acquired C, A took immediate steps to dispose of the facility by: hiring F to find ways to dispose of the facility; completely vacating all personnel and equipment from the facility; and then retaining and leaving the facility with a broker to sell the facility. These facts indicate that the withdrawal of the facility occurred relatively suddenly and should therefore further support a finding that the

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[1]The reference to range of years taken into consideration in fixing the depreciation rate is a reference to law prior to 1981 under which the depreciation deduction was a function of the useful life of property, which was based on facts and circumstances. Generally, for property placed in service under ACRS and MACRS, depreciation is a function of the statutorily fixed recovery period.

withdrawal of the facility resulted from a sudden loss of usefulness resulting from extraordinary obsolescence.

To establish that the withdrawal of the facility resulted from a sudden loss of usefulness resulting from extraordinary obsolescence, A can argue that the withdrawal of the facility occurred as a result of new developments in the industry, or similar like change, which rendered the facility economically worthless for A. A would argue that the acquisition of C by A and the business decisions made in the aftermath of this acquisition, which appear to be primarily motivated by economics, is a type of change resulting from new developments in the industry. Also, at least from C's standpoint, this was probably an unexpected occurrence. However, we should respond to this argument by pointing out that mergers and acquisitions of banks are frequent occurrences and usually they are accompanied by closings of branches and other facilities; thus, the closing of a facility such as this is not unusual or unexpected. See section 1.167(a)-9 for further discussion of obsolescence.

Finally, if we determine that A is entitled to recognize a loss for the retirement of the facility in tax year Date3, then it is not entitled to take depreciation deductions on the property for tax year Date3 and forward. On the other hand, if we determine that A is not entitled to recognize a loss for the retirement of the facility in tax year Date3, then A is entitled to take depreciation deductions on the facility for tax year Date3 through tax year Date5 when A sold the facility. See section 1.167(a)-10(b).

This writing may contain privileged information. Any unauthorized disclosure of this writing may have an adverse effect on privileges, such as the attorney client privilege. If disclosure becomes necessary, please contact this office for our views.

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