Internal Revenue Service

Department of the Treasury

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LEGEND

Taxpayer =

D =

Corporation A =
Business =
Replacement Property =
QI =
$B =
$C =
$D =
$E =
$F =
Date V =
Date W =
Date X =
Date Y =
Date Z =
Year 1 =
Year 2 =
Year 3 =

Dear

This letter responds to your authorized representative's letter of December 2, 1999, requesting a private letter ruling regarding the application of section 1033(g)(3) of the Internal Revenue Code ("Code") to the transaction described herein. Taxpayer's representations, as provided in your letters of December 2, 1999, March 8, 2000, June

12, 2000, and July 10, 2000, are set forth below.

Taxpayer requests four rulings. First, Taxpayer requests a ruling that the transaction described below qualifies as a like-kind exchange under section 1031, either pursuant to an election under section 1033(g)(3) of the Code or pursuant to other authorities. Second, Taxpayer requests a ruling that the election under section 1033(g)(3) will not change the 15-year recovery period of its signs. Third, Taxpayer requests a ruling that the election under section 1033(g)(3), being made effective only for the year ended October 31, 1999, and following years, has no impact on any prior years with respect to depreciation, investment credits, or any other tax consequence of the ownership and use of the signs in that, to the extent not already classifiable as real property, the election constitutes for purposes of the Code a change in character of the property in the current fiscal year, rather than a change in treatment with retroactive effects. Fourth, Taxpayer requests the Service's approval to make an election under section 1033(g)(3) as a conditional or protective election.

Taxpayer is a subchapter S corporation with D as its sole shareholder. Taxpayer has been in the outdoor advertising business since Year 1. During the course of its business, Taxpayer acquired or constructed signs which its clients used to display their advertisements. Taxpayer desires to change its business from outdoor advertising to Business. To effect this goal, Taxpayer entered into an asset purchase agreement with Corporation A on Date X, providing for the sale of the majority of Taxpayer's assets relating to its outdoor advertising business. The value assigned to the sale proceeds from the signs was $B. Of this amount, $C was attributed to signs which qualified for an election for real property treatment under section 1033(g)(3). Approximately one-fifth of the total sale proceeds were allocable to signs which did not qualify for the election.

As part of the asset purchase agreement, Taxpayer, Corporation A, and a qualified intermediary, QI, entered into an exchange agreement on Date Y, providing for a deferred exchange of Taxpayer's signs for Replacement Property owned by Corporation A. In order to implement the deferred exchange, Taxpayer transferred the signs to Corporation A. The sale proceeds paid by Corporation A were placed into an escrow account and used by QI to purchase the Replacement Property. The portion of the sale proceeds not used by QI to purchase the Replacement Property was disbursed to Taxpayer on Date Z. Taxpayer will declare this amount on its Form 1120S for Year 3.

The exchange agreement amended the asset purchase agreement to provide that Taxpayer assigns its rights and interests under the agreement to QI. In addition, the exchange agreement expressly limits Taxpayer's right to receive, pledge, borrow, or otherwise obtain the benefits of money or property held by QI as provided in section

1.1031(k)-1(g)(6) of the regulations.

The exchange agreement identified the relinquished properties as signs which qualify for the election under section 1033(g)(3). The signs consist of two types, those with steel supports and those with wood supports. Taxpayer represents that the wood supported signs may consist of either double faces or a single face. The sign faces are typically twelve feet high by twenty-five feet wide, and weigh 1,300 pounds, including point, hardware, and ad copy. The sign faces are composed of high density plywood and two by six inch lumber framing. The upper structure of the signs is supported by one or two wood columns twelve to sixteen inches in diameter, twenty-four to sixty feet in height, and twenty-five to thirty-five pounds per foot in weight. The columns are treated with creosote or a similar chemical preservative to protect against the elements. The columns are lowered eight to ten feet into the ground, and five to fifteen yards of concrete are poured into the hole surrounding them.

To disassemble the wood signs, the columns must be removed one at a time by a large and powerful construction crane. The columns are generally severed at ground level due to the time, labor, difficulty, and expense involved in removing the weighty concrete foundation and submerged columns. The columns are not reused by Taxpayer because it has represented that they are too short to meet Taxpayer's clients' needs. To attempt to reuse the columns would involve the digging of a hole larger than the concrete base to allow reinsertion in the ground. Taxpayer represents that it is simply not physically possible to repack the earth around the columns tightly enough to reproduce the physical strength of the direct pouring of concrete into the pit around the columns, as is done in the original construction of the sign. The sign face is not sufficiently rigid to exist in the absence of the columns and cannot be reused once the sign is disassembled. After removal of the sign, the face is effectively reduced to scrap lumber. Taxpayer represents that it would be more economical to start with new lumber than to attempt to remove the nails, bolts, and other fastenings, and otherwise refurbish the old lumber to reassemble it into a new sign. The wood signs have lasted for twenty to forty years, and require very little maintenance other than refastening of their components and replacement of their plywood faces, both of which are seldom necessary. Taxpayer represents that during a severe wind storm in Year 2, the vast majority of its signs suffered no damage to their faces or support columns.

Taxpayer represents the majority of its steel supported signs as having twelve foot high, by twenty-five foot wide sign faces, weighing up to thirty percent more than those used for the wood signs. The faces are composed of either metal or high density plywood and steel or wood framing. The sign faces are mounted onto a steel support column or columns. The signs may have a single face, or a double face, consisting of two sign faces of the same dimensions placed next to one another. The average supporting column measures two and one-half to five feet in constant diameter from top

to bottom. The columns do not generally taper, except in rare cases in which different diameter tubes are “telescoped” inside each other and welded together. The average column is thirty-two feet long and weighs 143 pounds per foot. The columns are welded to a steel reinforcement bar that is embedded in the ground at a depth of eight to ten feet. Liquid concrete is poured around the columns and bar to set them in place. A small number of Taxpayer’s signs with steel columns are bolted to a concrete foundation. As with the wood signs, Taxpayer has stated that five to fifteen cubic yards of concrete are used in the foundation, depending upon the condition of the soil at the location and the height of the sign. A few of Taxpayer’s steel supported signs are designed to be situated on riverbanks. Such signs are comprised of six steel columns embedded sixty feet into the ground.

The steel signs may be removed only by use of a large crane, at considerable expense. The removal process would render the entire sign structure unusable. The upper sign structures, including the sign faces, are inextricably attached to the steel columns, which makes it impossible to remove them without destroying them. As with the wood signs, the columns are usually removed by severing them at ground level and leaving the concrete foundation, steel reinforcement bar, and the remaining eight to ten feet of column underground. The columns are not reused because their overall height is reduced by being severed at ground level. If the submerged part of the columns and concrete foundation are removed, both would be destroyed since they are set firmly together when the sign is installed. The small number of Taxpayer’s signs which are bolted to a concrete foundation cannot be removed intact due to the welded construction of the upper sign structure and framing attached to the supports. Taxpayer represents that such assembly requires cutting apart for removal.

Taxpayer represents that $D is an accurate estimate of the approximate cost of the removal of one of Taxpayer’s average steel or wood supported signs. In addition to removing the old sign and hauling the scrap metal, the estimate includes the digging of new footings and the assembly of the component parts of a new sign. If the digging of new footings and the assembly of the component parts are not counted in the estimate, then Taxpayer represents that the estimate would decrease by approximately $E. Taxpayer represents that the estimate does not include the removal of the sign foundation. The removal of the foundation would increase the estimate by approximately $F.

With respect to the signs to which the sales proceeds of $C are attributable, Taxpayer will make an election under section 1033(g)(3) on its federal tax return for the taxable year ended Date V to treat such signs as real property. Taxpayer represents that it did not claim the investment credit or make a section 179(a) election for these signs. For depreciation purposes, Taxpayer represents that it consistently treated the signs for which the section 1033(g)(3) election will be made as real property and

classified the signs as depreciable land improvements under asset class 00.3 or 57.1 of Rev. Proc. 87-56, 1987-2 C.B. 674, depending on whether or not the sign is used in connection with service stations. Taxpayer computed the depreciation for these signs under section 168 of the Code by using a recovery period of 15 years.

Taxpayer represents that the identification and receipt requirements of section 1.1031(k)-1(b) of the Income Tax Regulations regarding the replacement property have been met and that QI satisfies the definition of a qualified intermediary under section 1.1031(k)-1(g)(4) of the regulations.

Law and Analysis

Request 1: Qualification as Like-Kind Exchange under Section 1031 Using a Section 1033(g(3) Election

Section 1031(a)(1) of the Code provides that no gain or loss shall be recognized on the exchange of property for productive use in a trade or business or for investment if such property is exchanged solely for property of a like-kind which is to be held either for productive use in a trade or business or for investment.

Section 1.1031(a)-1(b) of the regulations provides, in pertinent part, that as used in 1031(a) the words "like-kind" refer to the nature or character of the property and not to its grade or quality. One kind or class of property may not be exchanged for property of a different kind or class. The fact that any real estate involved is improved or unimproved is not material, for that fact relates only to the grade or quality of the property and not to its kind or class.

Section 1033(g)(3)(A) of the Code provides that a taxpayer may elect, at such time and in such manner as the Secretary may prescribe, to treat property which constitutes an outdoor advertising display as real property for purposes of chapter 1 of the Code.

Section 1033(g)(3)(C) of the Code defines an outdoor advertising display as a rigidly assembled sign, display, or device permanently affixed to the ground or permanently attached to a building or other inherently permanent structure constituting, or used for the display of, a commercial or other advertisement to the public. Highway billboards affixed to the ground with wood or metal poles, pipes, or beams, with or without concrete footings are outdoor advertising displays. Treas. Reg. § 1.1033(g)-1(b)(3).

Section 1.1033(g)-1(b)(1) of the regulations provides, in pertinent part, that the election is available for taxable years beginning after December 31, 1970. No election

may be made with respect to any property for which (i) the investment credit under section 38 has been claimed, or (ii) an election to expense certain depreciable business assets under section 179(a) is in effect.

Based on Taxpayer's representations, we conclude that Taxpayer's signs satisfy the definition of "outdoor advertising display" in section 1033(g)(3)(C) and that Taxpayer may make an election under section 1033(g)(3)(A) to treat these signs as real property for purposes of chapter 1 of the Code. As a result, we conclude that Taxpayer's signs are like-kind to the Replacement Property. Based on Taxpayer's representations that the identification and receipt requirements of section 1.1031(k)-1(b) of the regulations have been met and that QI is a qualified intermediary under section 1.1031(k)-1(g)(4) of the regulations, the exchange of the properties qualifies as a like-kind exchange under section 1031.

Taxpayer alternatively requested a ruling that by virtue of principles of law, regulation, revenue ruling, or other authorities its signs be considered real property without regard to section 1033. Because we rule favorably on Taxpayer's election under section 1033(g)(3), we decline to rule on this alternative position. See section 7.01 of Rev. Proc. 2000-1, 2000-1 I.R.B. 4, 21.

Request 2: Recovery Period of Signs

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 section 167(a) generally is determined by using the applicable depreciation method, recovery period, and convention.

The classification of property for purposes of section 168 is determined under section 168(e). Section 168(e)(1) provides that 15-year property is property with a class life of 20 or more years but less than 25 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 section 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 section 167(m).

Former section 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 sections 1.167(a)-11(b)(4)(ii) and 1.167(a)-11(b)(4)(iii)(b) of the regulations. Those sections provide that property is included in

the asset classes established and periodically published in revenue procedures (Rev. Proc. 87-56, 1987-2 C.B. 674, which is in effect for section 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 section 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.

Rev. Proc. 87-56 provides that asset class 00.3, Land Improvements, includes improvements directly to or added to land, whether such improvements are section 1245 property or section 1250 property, provided such improvements are depreciable. Asset class 57.1, Distributive Trades and Services-Billboards, Service Station Buildings and Petroleum Marketing Land Improvements, of Rev. Proc. 87-56 includes, among other things, billboards, whether such assets are section 1245 property or section 1250 property. Depreciable property included in either asset class 00.3 or 57.1 of Rev. Proc. 87-56 has a class life of 20 years and, consequently, is classified under section 168(e)(1) as 15-year property.

The determination under section 168 of whether Taxpayer's signs are 15-year property that are included in either asset class 00.3 or 57.1 of Rev. Proc. 87-56 depends on the signs' permanency. This determination is made by using the factors set forth in Whiteco Industries, Inc. v. Commissioner, 65 T.C. 664, 672-673 (1975). See Rev. Rul. 80-151, 1980-1 C.B. 7.

If Taxpayer's signs are inherently permanent structures for depreciation purposes under the factors set forth in Whiteco and are depreciated under section 168 of the Code, the signs are included in either asset class 00.3 or 57.1 of Rev. Proc. 87-56 depending upon their use. Consequently, the signs have a class life of 20 years and, thus, are classified under section 168(e)(1) as 15-year property. If the signs are depreciated in accordance with the general depreciation system of section 168(a), the applicable recovery period for the signs after the section 1033(g)(3)(A) election is made is 15 years pursuant to section 168(c). If, however, the signs are depreciated in accordance with the alternative depreciation system of section 168(g), the applicable recovery period for the signs after the section 1033(g)(3)(A) election is made is 20 years pursuant to section 168(g)(2)(C)(i).

In the present case, Taxpayer represents that before it made the section 1033(g)(3) election for its signs, Taxpayer consistently treated these signs as real property for depreciation purposes and classified the signs as depreciable land

improvements under asset class 00.3 or 57.1 of Rev. Proc. 87-56, depending on whether or not the sign is used in connection with service stations. Taxpayer also represents that it computed the depreciation for the signs under section 168 of the Code by using a recovery period of 15 years. Taxpayer did not state whether or not the alternative depreciation system of section 168(g) applies to any of the signs at issue.

Based solely on Taxpayer's representations and the law and analysis as set forth above under request two, we conclude that Taxpayer's election under section 1033(g)(3) to treat its signs as real property for purposes of chapter 1 of the Code will not change the 15-year recovery period of the signs depreciated under section 168, provided the alternative depreciation system of section 168(g) does not apply to the signs and the signs are inherently permanent structures for depreciation purposes under the factors set forth in Whiteco.

Request 3: Retroactive Effect of Election

Taxpayer requested in ruling request three that the Service rule that the election under section 1033(g)(3), being made effective only for the year ended October 31, 1999, and the following years, has no impact on any prior years with respect to depreciation, investment credits, or any other tax consequence of the ownership and use of the signs in that, **to the extent not already classifiable as real property**, the election constitutes for purposes of the Code a change in character of the property in the current fiscal year, rather than a change in treatment with retroactive effects (emphasis added). However, Taxpayer represents that the signs at issue "have all consistently been treated as real property." Because of this representation, ruling request three involves a hypothetical situation. Accordingly, pursuant to section 7.02 of Rev. Proc. 2000-1 and section 3.02(3) of Rev. Proc. 2000-3, 2000-1 I.R.B. 103, 108, the Service declines to issue a ruling on this issue.

Request 4: Conditional or Protective Election

Taxpayer has requested the Service's approval to make an election under section 1033(g)(3), conditioned upon our ruling favorably on the issue of whether the transaction qualifies for non-recognition of gain under section 1031(a). Taxpayer has stated that if we determine that the transaction will not qualify as a like-kind exchange under section 1031, it will derive no benefit from making an election pursuant to section 1033(g)(3). Since we are issuing a favorable ruling under section 1031(a), there is no need to address this issue.

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Except as specifically ruled upon above, no opinion is expressed or implied

regarding the application of any other provision of the Code or regulations. Specifically, we make no determination as to the classification of the Replacement Property, and assume for purposes of this analysis that the Replacement Property constitutes real property. We make no determination as to taxpayer's representations that the identification and timing requirements have been met under section 1.1031(k)-1(b) of the regulations, or that QI meets the definition of a qualified intermediary under section 1.1031(k)-1(g)(4) of the regulations. No opinion is expressed or implied regarding the depreciation method, recovery period, and convention to be used for determining the depreciation deduction allowable for the Replacement Property that was acquired with the proceeds from the sale of the signs.

This ruling is directed only to the taxpayer requesting it. Section 6110(k)(3) of the Code provides that it 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. 2000-1, 2000-1 I.R.B. 4, 46. However, when criteria in section 12.05 of Rev. Proc. 2000-1 are satisfied, a ruling is not revoked or modified retroactively, except in rare and unusual circumstances.

A copy of this letter must be attached to any income tax return for the year in which the transaction in question occurs. We enclose a copy for that purpose. In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to your authorized representative.

Sincerely,

HEATHER C. MALOY
Associate Chief Counsel (Income Tax & Accounting)

By: _____
DOUGLAS FAHEY
Acting Branch Chief
Branch 5

enclosures (2):
6110 copy
copy of ruling