INTERNAL REVENUE SERVICE
NATIONAL OFFICE TECHNICAL ADVICE MEMORANDUM

November 23, 2009

Number: **201014052**
Release Date: 4/9/2010

Third Party Communication: None
Date of Communication: Not Applicable

Index (UIL) No.: 165.01-00, 165.07-00
CASE-MIS No.: TAM-119625-09

Team Manager

Taxpayer's Name:
Taxpayer's Address:

Taxpayer's Identification No
Year(s) Involved:
Date of Conference:

LEGEND:

Taxpayer =
=
A =
B =
C =
D =
Year 1 =
Year 2 =
Year 3 =
Tracking System =

ISSUE:

What is the "single, identifiable property" by reference to which casualty losses incurred by Taxpayer, a telecommunications company, as a result of should be

determined under § 165 of the Internal Revenue Code and the corresponding regulations?

CONCLUSION:

For this purpose, it is reasonable to treat the central office building in a telecommunications wire center as a single, identifiable property; the central office equipment inside a wire center building ("central office equipment") as a single, identifiable property; and the outside wiring and other assets connected to a wire center (“outside plant property”) as a single, identifiable property.[1]

FACTS:

Taxpayer is a headquartered in A. Taxpayer is, and was during the relevant period, a provider of telecommunications services. The services provided by Taxpayer include local exchange, long distance, network access, and internet services.[2] severely affected Taxpayer network properties during the latter half of Year 1. As a result of these casualties, Taxpayer sustained approximately $ in damages. Taxpayer, on its Year 1 tax return, claimed a $ casualty loss deduction under § 165.[3] The loss was calculated under § 1.165-7 of the Income Tax Regulations based on the costs to repair its system (excluding betterments), using the wire center, defined below, as the single, identifiable property damaged by .

Currently the telephone system in the United States is provided by approximately 1,300 incumbent local exchange carriers, or ILECs, who own and operate the network infrastructure. Some incumbent carriers provide service to a single town, while others may provide service to an entire county. The incumbent carriers usually operate as cooperatives, private and publicly held corporations, or public utilities owned by the local government.

There are also approximately 600 competitive local exchange carriers, or CLECs, who have access to the ILEC’s infrastructure for a fee. The only equipment a CLEC has to provide is its own switching ability, generally via equipment located in the ILEC’s central office.

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[1]

[2] The scope of this memorandum includes only assets used for wireline/landline infrastructure. It does not include assets used exclusively to . It also does not include assets that are not part of a wire center, such as .

[3]

Physical Structure of the Telephone System

Overview

All incumbent carriers' networks are interconnected directly or indirectly via a long distance carrier or shared trunks. Each carrier has designated service areas made up of local access transport areas or LATAs. Within each LATA are local exchange areas that contain local lines and a local switch or switches. Each phone number is made up of ten digits. The LATA is generally designated by the first three digits, which are commonly known as the area code. The next set of three digits designates the local exchange and the last four digits are those of the telephone address. A call made outside the LATA is a long distance call.

A wireline telephone converts sound into electricity, which travels through copper or fiber cables to a central office. The pathway from a customer's premise to the central office is called a local loop. This loop from the central office to the customer's premise is typically a dedicated access circuit, which means that each customer's telephone has a "twisted pair" of two copper wires (one wire to transmit, another wire to receive) dedicated to its service. Traditionally, central offices that are connected to copper wires had a serving area of three miles radius around them, or about 27 square miles. Today, if fiber optic is used in place of copper cable, the service area may be larger.

At the central office, the wires are connected to a telephone switch. If the call recipient is served by the same central office, the switch connects the caller's wires to the recipient's wires. If the call recipient is served by a different central office, the switch connects the call to a long distance trunk.

The Wire Center

Taxpayer's infrastructure is composed of wire center sub-networks. The term "wire center," originally used to describe only the central office physical structure, is now used to encompass the geographic area served by the central office and the telecommunications assets that serve that area. Each wire center is connected via a trunk to its contiguous area wire centers and connected to a long distance trunk line. If the central office system fails switching service may be shifted to a linked central office. Trunks are typically copper or fiber cables bundled together and designed for the signal to travel the greater distance between central offices. Each wire center consists of the central office structure itself, the switching and related equipment housed in the central office, and the wiring and other outside plant property, as described below.

Within the telecommunications industry, wire centers are well established as the standard grouping of integrated network components that make up the local telephone exchange system. Each separately identifiable wire center includes the network equipment used to serve a unique set of customers, represented by unique telephone

numbers within a fixed geographic and local exchange area. For regulatory purposes, the Federal Communications Commission ("FCC") and state public utility commissions require regulated telecommunications companies to maintain detail of service quality data on a wire-center basis. Taxpayer's management tracks information about by wire center, and Taxpayer's are assigned responsibilities by wire center.

Central Office Building

The central office building is a highly secured building that houses the central office equipment.

Central Office Equipment

The central office acts as a control point or switching hub within the wire center. , Taxpayer classified the main equipment housed in the central office into basic categories:

There are three types of main distribution frames, the conventional frame, the cosmic frame, and the modular ESS frame. They all serve the same function, to house the equipment where cross-connections between the outside cable pairs and the central office switching and transmission equipment are made.

Switching equipment is an important piece of a voice telephone network. Most switches have been upgraded from analog to digital. Components of a digital switch include the central processor, the switching module, and the input/output controller. The central processor identifies the call in and call out information, validates the customer, determines the most efficient path to send the call, routes the call and records billing information. The switching module performs time division switching to establish connections with incoming and outgoing circuits. The input/output controller allows access to the switch via an interface through a computer console, and is also used to load new generations of software that controls the switch's operations and records detailed billing information about each call.

Transmission equipment includes those assets that physically transport information over distance. The major types of equipment include multiplexers,[4] which combine a number of signals in order to form a single composite signal, allowing many calls to be transmitted over one set of wires; repeaters, which increase signal strength to transmit over greater distances; the digital cross-connect system; channel banks; modulators; regenerators; and signal converters.

The central office typically has an extensive battery system, as well as a backup generator, to supply power during a power failure. Under normal conditions, a charging system charges a group of batteries, while providing DC power to the telephone lines and equipment. In the event of an emergency, the generator replaces the electrical power normally supplied by the electric company.

Outside Plant Property

Outside plant property includes the assets located outside of the central office that link the central office to the customer.

Feeder Cables

Feeder cables extend between the central office or digital loop carrier remote terminals and the distribution facilities. One or more feeder cables form a feeder section, with multiple feeder sections forming a feeder route. Feeder sections are used to measure and forecast cumulative demand and capacity. Taxpayer's feeder sections are numbered and annotated on their property and work order records, usually with a system. The feeder cable's precise numbering system, when combined with the wire center's CLLI code, provides Taxpayer the ability to identify .

Distribution Areas

Feeder cables connect to distribution facilities, most commonly through a cross-connect, sometimes directly in cable splices. Assets in the distribution facility include all cables (except those feeder cables that connect to the central office), conduits, ducts, poles, towers, repeaters, rectifiers, amplifiers, cross connect boxes, serving terminals, network area interface devices, and other equipment up to the demarcation point of a customer.

Planning and construction of distribution facilities is conducted by reference to either a distribution area, an allocation area, or a carrier serving area, depending upon the technology available in the area subdivided.

A distribution area is a geographic area containing up to 600 telephone lines linked to the wire center's central office with a feeder line. A relatively rural distribution area may cover a large area, whereas a commercial office or apartment building itself may be an entire distribution area. An allocation area is the administrative combination of up to five distribution areas. It involves grouping distribution areas with similar characteristics into larger units for planning spare capacity utilization, growth rates, and the type of distribution facilities. A carrier serving area is the digital equivalent of a distribution

area, measured not by the number of phone lines but by the speed with which a customer can be served.

Engineers use distribution areas, allocation areas, and carrier serving areas to determine when and how to invest in additional equipment, to ensure that customer service is not compromised and that Taxpayer is not unnecessarily investing in additional lines.

Outside Plant Configurations

There are three standard system designs that are used in a wire center configuration; various configurations could be used within one wire center. The first design is a direct connect where a bundle of copper wire runs from the central office to a neighborhood and connects to a cross box. The cross box separates the copper wire down to individual twisted pairs for each customer. The twisted pairs are bound together based on street location and run from the cross box down the street to the serving terminal, which is usually located on the pole or at a pedestal box. The twisted pair for each customer then runs from the pole to the customer premise and network area interface device.

In rural areas or with large businesses there may be a direct copper feed. The customers are located at greater lengths apart and the copper would connect directly to the customer premise from the serving terminal.

The second copper design is similar to the first; however, there may be conversion of the signal from analog to digital.

The third design is the fiber connection via a remote terminal. The fiber connects the central office to the remote terminal. Copper connects the remote terminal to the serving terminal located at the pedestal or pole connection and then ultimately the customer premise. Since copper still travels from the customer premise to the remote terminal, there is usually a cross box that bundles the copper lines, which connect to a multiplexer at the remote terminal.

The wire center configurations for Taxpayer in Year 1 included variations of these three system configurations. Actual configurations are considerably more complex, with additional provisions for analog to digital conversion and multiplexing.

Insurance

[5]

[5] Section 165(a) provides that a loss deduction is allowed only for losses not compensated for by insurance. This memorandum assumes this requirement has been met.

Wire Center Transactions

Sales of wire centers by have occurred over the years. sold a wire center in B in , purchased several wire center areas in C with , and sold wire centers in . In addition, there was a proposed project in to divest low-profit wire centers that . Neither Taxpayer, nor any other wireline telecommunications company, generally buys or sells smaller existing or "in place" components of a wire center.

, was required to offer unbundled network elements to CLECs. Unbundled network elements together make up a loop that connects to a digital subscriber line access multiplexer or a voice switch (or both). The loop allows non-facilities-based telecommunications providers to deliver service without laying network infrastructure.

Recovery

When occurs, Taxpayer's personnel detect signal failures and degradation in Taxpayer's system. If trouble is indicated, a call cannot be automatically re-routed. A technician must be dispatched to determine the problem and take the appropriate corrective action.

Generally, the further from the central office the damage is, the fewer customers that are affected. If a serving terminal or remote terminal is damaged, only customers serviced by that terminal are affected. Damage to a feeder cable may affect multiple remote terminals, and disrupt service to more customers; however, customers served by undamaged feeders would not be affected. Likewise, damage to a central office may affect all the customers within the wire center serviced by that central office, unless that function can be handled temporarily by another central office.

Taxpayer tries to restore service to the most customers as quickly as possible. For example, it would generally repair damages to the central office before repairing the individual feeder cables in and out of that wire center. It would repair the larger cables serving the most customers before smaller ones, and so on, until it finally got down to the individual customer level.

Taxpayer's engineers track the repair costs under a separate work authorization number in Taxpayer's Tracking System. Where its engineers improve, as opposed to merely replace, equipment, they record the improvements, explain why they upgraded the equipment, and document the cost differential.

Tax and Nontax Accounting

The FCC is charged with regulating interstate and international communications by radio, television, wire, satellite and cable. Its Wireline Competition Bureau develops and recommends policy goals, objectives, programs and plans for the Commission on matters concerning wireline telecommunications. Since Taxpayer provides communication services by wire, the FCC maintains oversight over its accounting systems. The Uniform System of Accounts under 47 C.F.R. Part 32 ("USoA") has been prepared to provide the financial accounts of a company to be used in recording the basic transactions that occur when providing telecommunication services.

The telecommunications plant account guidelines are provided in 47 C.F.R. Part 32, Subpart C, and include FCC account series 2000 through 2600. These asset groupings are generally based on function: "[T]he primary bases of the accounts containing the investment in telecommunications plant are the functions performed by the assets." 47 C.F.R. § 32.2(b).

47 C.F.R. § 32.2000(f)(1)(i) provides that a company's property record, "as related to each primary plant account, shall be established and maintained by subaccounts for each accounting area. An accounting area is the smallest territory of the company for which accounting records of investment are maintained for all plant accounts within the area." Taxpayer's accounting area is the .

Within an accounting area, a company must establish property record units, classified by size and type. 47 C.F.R. § 32.2000(f)(2)(i). The records show the identity, vintage, location and original cost of units of property. Id.; 47 C.F.R. § 32.2000(e)(1)(i). Cost may be estimated using average costs for groups of similar units, by vintage, by accounting area. 47 C.F.R. § 32.2000(d)(3), (f)(3)(i)(ii).

Telecommunications Plant in Service, Account 2001, is subdivided into groups of accounts and subaccounts. Accounts in the 2200 series are grouped as "Central Office assets." Accounts in the 2400 series include poles, aerial wire and cable, underground cable, and other "Cable and wire facilities assets." 47 C.F.R. § 32.2000(j).

Rev. Proc. 87-56, 1987-2 C.B. 674, sets out the asset classes and recovery periods for purposes of I.R.C. § 168 (“MACRS”). Asset classes 48.12 through 48.14 describe the primary asset classes in which Taxpayer records its wireline telephony assets. These asset classes are generally based on the FCC/USoA asset groupings.[6]

[6] Asset classes 48.11 through 48.14 of Rev. Proc. 87-56 are based on the FCC Uniform System of Accounts under 47 C.F.R. Part 31 (as contained in the 47 CFR Part 31 edition as of October 1, 1986). The FCC revised and issued these accounts under 47 C.F.R. Part 32. Generally, the current FCC/USoA asset groupings are similar to the asset groupings under 47 C.F.R. Part 31 (for example, FCC account 32.2411, Poles, was former 31.241, Pole lines).

Taxpayer does not use , see § 168(i)(4), and technically computes depreciation on a . However, as in the case of its accounting, it generally does not track

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but aggregates its tax accounting records by and by .

Year 1 Casualties

Taxpayer's facilities sustained damage in Year 1. Of Taxpayer's approximately wire centers, were affected by .

, Taxpayer launched repair efforts to restore service to customers in the affected areas. Costs incurred were charged to the project code " " which included work authorization numbers that tracked costs incurred by wire centers. After the work was completed, Taxpayer was then able to accumulate the repair costs to the damaged area using its Tracking System.

For preparation of its Year 1 Federal tax return, Taxpayer relied upon its Tracking System to identify costs incurred by asset category (subaccount) within a wire center. While Taxpayer separately accounts for its individual assets in numerous ways

, it also summarizes assets by asset class as set forth by the FCC and Rev. Proc. 87-56. Using this established accounting system, Taxpayer was able to identify by wire center the types of assets that were damaged and needed to be replaced or repaired. It computed its casualty loss by analyzing the diminution in fair market value and adjusted basis of the entire wire center, considered as one "single, identifiable property."[7]

LAW AND ANALYSIS:

Law

Section 165(a) of the Internal Revenue Code allows a deduction for any loss sustained during the taxable year and not compensated for by insurance or otherwise.

Section 165(b) provides that the basis for determining the amount of the deduction for any loss is the adjusted basis provided in § 1011 for determining loss from the sale or other disposition of the property.

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[7] See §1.165-7(b)(1). The cost of repairs was used as a measure of the loss in value attributable to the casualty, for purposes of calculating the casualty loss deduction. See § 1.165-7(a)(2)(ii). Whether or the extent to which these costs were deductible under § 162, or must be capitalized under § 263, is an issue not addressed in this technical advice request.

Section 1.165-7(a)(1) of the Income Tax Regulations provides that any loss arising from fire, storm, shipwreck, or other casualty is allowable as a deduction under § 165(a) for the taxable year in which the loss is sustained.

Section 1.165-7(b)(1) provides that the amount of the loss to be taken into account for purposes of § 165(a) is the lesser of either—(i) The amount which is equal to the fair market value of the property immediately before the casualty reduced by the fair market value of the property immediately after the casualty; or (ii) The amount of the adjusted basis prescribed in § 1.1011-1 for determining the loss from the sale or other disposition of the property involved. However, if business or investment property is totally destroyed by casualty, and the fair market value of the property immediately before the casualty was less than the adjusted basis of the property, the adjusted basis is treated as the amount of the loss.

Section 1.165-7(a)(2)(i) provides, in part, that in determining the amount of the deductible loss, the fair market value of the property immediately before and immediately after the casualty shall generally be ascertained by competent appraisal. However, § 1.165-7(a)(2)(ii) provides that the cost of repairs to the property damaged is acceptable as evidence of the loss of value if the taxpayer shows that (a) the repairs are necessary to restore the property to its condition immediately before the casualty, (b) the amount spent for the repairs is not excessive, (c) the repairs do not care for more than the damage suffered, and (d) the value of the property after the repairs does not as a result of the repairs exceed the value of the property immediately before the casualty.

Section 1.165-7(b)(2)(i) provides, in part, that a business or investment loss is determined by reference to the single, identifiable property damaged or destroyed. Thus, for example, in determining the fair market value of the property before and after the casualty in a case where damage by casualty has occurred to a building and ornamental or fruit trees used in a trade or business, the decrease in value is measured by taking the building and trees into account separately, and not together as an integral part of the realty, and separate losses are determined for such building and trees. Section 1.165-7(b)(2)(ii) provides a special aggregation rule under which improvements are considered an integral part of real property that is not used for business or investment.

Analysis

The request for technical advice focuses on the single, identifiable property by reference to which Taxpayer's casualty losses should be determined.

For purposes of quantifying the loss in value attributable to under § 1.165-7(b)(1), Taxpayer used the cost-of-repairs method permitted by § 1.165-7(a)(2)(ii). Largely because Taxpayer's assets have been depreciated, the basis limitation in § 1.165-7(b)(1)(ii) came into play, and the unit of property for casualty loss purposes is

significant because the cost of repairs may exceed basis—depending on the size of the "single, identifiable property" that is used to make the determination.

In determining the basis limitation, Taxpayer proposes that each wire center is the "single, identifiable property" that was damaged by .[8]

The examination team proposes that the "single, identifiable property" damaged or destroyed by is each asset category or FCC subaccount for each wire center. Alternatively, the examination team proposes that the assets in a wire center should be divided into separate groupings based on functionality. Outside plant property would be divided into the separate feeder cables and the separate distribution areas or equivalent serving areas. Inside plant property would be divided into the building itself, the main distribution frames, the switching equipment, the transmission equipment, the power equipment, and each piece of equipment with its own unique functions (vehicles, etc.)

The field has also indicated that it would accept a subdivision of

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The parties agree that certain wire center assets that are peripheral to providing two-way communications are separate “single, identifiable properties.” These assets, based on Taxpayer's reporting, include

.[9]

The field would accept a division of the remainder of the wire center into building, central office equipment, and outside plant property.

In our view, Taxpayer's methods of quantifying its loss employ units of property that are unreasonably large; by the same token, use of the FCC subaccount, as proposed by the examination team, is not fully supported by the factors cited in the relevant case law. We conclude that a functional division into the building itself, central office equipment within a wire center, and outside plant property within a wire center, without further subdivision, is a reasonable method to use on the facts of the present case. This conclusion is supported by the language of the regulations, and by the intent of the regulations and the factors to be used in applying them, as evidenced in the case law.

Section 165 regulations

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[8] Alternatively, Taxpayer proposes that all the assets used to provide voice and data services within a constitutes one unit of property for this purpose. We will not separately discuss this alternative; the discussion of the wire center as a "single, identifiable property" applies, *a fortiori*, to this alternative.

[9] No implication is intended with respect to whether any of these asset groups are further divisible into assets or groups of assets each of which would be a "single, identifiable property."

Under the § 165 regulations, a casualty loss is determined by reference to the "single, identifiable property damaged or destroyed." The language of the regulation itself supports a relatively narrow construction of the term:

> Therein, the term 'property' is clearly adjectivally defined and limited by the phrases 'single identifiable' and 'damaged or destroyed'. . . . These descriptives or modifiers unmistakably constrict the permissible interpretation of 'property,' rather than broaden it.

Weyerhaeuser Co. v. United States, 32 Fed. Cl. 80, 100 (1994), aff'd in part and rev'd in part, 92 F.3d 1148 (Fed. Cir. 1996). An example in the regulations provides that where damage by casualty has occurred to an office building, land, and ornamental plantings, the decrease in value and the basis limitation are both measured by taking the building, land, and plantings into account separately, with separate losses being determined for each. § 1.165-7(b)(3), Ex. (2).[10]

Case law

Some general principles as to what constitutes a "single, identifiable property" can be taken from the case law.

The current regulations were adopted after the courts rejected the "percentage of basis" rule for business casualty losses reflected in the prior regulations.[11] In Alcoma Association v. United States, 239 F.2d 365, 369 (5th Cir. 1956), the court pointed out the merits of a rule that permitted use of the entire basis of a functional unit of business property: "Where a partial loss of an indivisible business property is suffered it may well be necessary to restore the damage in full by immediate repairs and replacements before any portion of the property is again usable." The court cited the example of an automobile, "which cannot be destroyed piece by piece without affecting the utility of the whole, and which thus clearly has an undivisible [sic] 'basis.'" Id. at 368.

In response, the Service replaced the percentage of basis business rule in 1959 with the "single, identifiable property" rule, which was later upheld by the courts. See Carloate Industries v. United States, 354 F.2d 814 (5th Cir. 1966) (land and citrus groves are separate properties); Keefer v. Commissioner, 63 T.C. 596 (1975) (land and buildings separate).

The courts have expanded on the purposes behind the basis limitation in § 165(b) generally and the "single, identifiable property" rule specifically. Generally, the basis limitation prevents a deduction for a loss of value in excess of basis, such as unrealized

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[10] By contrast, taxpayers who sustain a loss to personal-use real property, such as a home, may aggregate land, buildings, and plantings in determining their loss. § 1.165-7(b)(3), Ex. (3).

[11] Under the percentage of basis approach, if property lost, for example, 60% of its value, the taxpayer would deduct 60% of its basis.

appreciation. See Rosenthal v. Commissioner, 416 F.2d 491, 497 (2d Cir. 1969). More specifically, the "single, identifiable property" rule ensures that a taxpayer may not borrow basis from unharmed property in order to increase the amount of a loss deduction for an injury to other property. See id. at 497-98; Keefer, 63 T.C. at 600.[12]

In a series of cases, most involving timber, the courts further developed some of the factors to be used in the determination.

In Westvaco Co. v. United States, 225 Ct. Cl. 436 (1980), storms and fire damaged the taxpayer's timberlands. The Government took the position that the "single, identifiable property" was each unit of merchantable timber contained in trees suffering mortal injury, limiting the allowable deduction to the adjusted bases of these units, as carried in the depletion accounts. The court instead determined that the "single, identifiable property" was the depletion account, or "block" (an aggregation of timber used to compute depletion), citing several factors: The depletion block was a logical and reasonable unit for purposes of valuation and accounting; was the only unit that remained constant and identifiable for tax purposes, and had a cost or adjusted basis that was not changed except by elimination of an asset or by injection of capital; was a reasonable and identifiable area affected by the casualty; was a unit that was, or could be, normally bought and sold by the taxpayer; was consistent with the taxpayer's tax accounting for depletion purposes; did not prevent the taxpayer from realizing the full extent of the loss (physical damage to immature timber, on the facts of the case); was generally consistent with industry practice; and was chosen based in part on considerations of forestry operation and management.

Westvaco was subsequently applied in a similar timber case, Weyerhaeuser Co. v. United States, 92 F.3d 1148 (Fed. Cir. 1996), aff'g in part and rev'g in part, 32 Fed. Cl. 80 (1994), which involved casualties caused by fires, insects, and a volcanic eruption. The court reversed the lower court's determination that the "single, identifiable property" was the tree "stand" rather than the depletion block, holding that Westvaco was controlling, and agreeing with the Westvaco opinion that the depletion block "met both the accounting needs imposed by the tax code and the operational needs of effective forest management"; that it "maintained its own 'identifiable adjusted basis unaffected by other such units'"; and that it was logical and reasonable "to use the same property unit for casualty loss purposes as had been consistently used for tax accounting purposes." 92 F.3d at 1151 (citations omitted).[13]

In an issue that was not appealed, the lower court in Weyerhaeuser also agreed with the taxpayer that its seven logging road systems and a logging railroad system each

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[12] The rule also allows a business taxpayer to recover more easily basis in property that is completely destroyed by casualty, when the drop in value is less than basis; a large unit of property is less likely to be completely destroyed. See § 1.165-7(b)(1).

[13] See also International Paper Co. v. United States, 39 Fed. Cl. 478 (1997). The Service conceded the issue, with respect to timber, in Rev. Rul. 99-56, 1999-2 C.B. 676, rev'g Rev. Rul. 66-9, 1966-1 C.B. 39.

constituted separate "single, identifiable properties"—rejecting the Government's position, which was based on the portions of each system that sustained damage. The Court noted that the taxpayer "built integrated road systems and a unitary railroad whose utility as assets derive from their functioning as a whole." Id. at 104. However, the Court went on to stress that its holding was limited to these single-purpose networks, which the taxpayer accounted for and depreciated as units, and as to which "no subdivision … was made by plaintiff for any reason related to identification of the assets of the company." Id. at 105. Addressing Louisville and Nashville R.R. Co. v. Commissioner, T.C. Memo 1987-616, which involved loss of railroad grading, the court distinguished a situation involving a rail system used in the primary business of operating a railroad, which "serves varied and vast areas," observing that Weyerhaeuser's logging railroad was not "commercially segmentable"; that "its function and use are to benefit a discrete realm … one area of timberland"; and that it was "one functioning unit that serves a specific and limited territory." Id. at 106.

Estate of Rinaldi v. United States, 38 Fed. Cl. 341 (1997), involved the use of the "single, identifiable property" in determining value, not basis, under § 1.165-7(b). The Government argued that the "single, identifiable property" was each individual freeze-damaged citrus tree. The court adopted the taxpayer's position that the entire citrus grove should be valued as one "realistic economic unit." Citing the timber cases, the court reasoned that the grove was the only "unit with a realistic market value." Id. at 355. The court noted the case law's common-sense approach to casualty loss calculation, the practical operation of the taxpayer's citrus grove, and the purpose and method of the taxpayer's appraisal: "[T]he economic unit by which a taxpayer's casualty losses are measured should be of a nature and scope that make practical sense." Id.

Summarizing, the determination of the "single, identifiable property" involves the application of a number of factors, none of which is dispositive, to arrive at a reasonable unit of property taking into account the nature of the casualty and the facts and circumstances of the particular case. Although we must be cautious in applying cases involving timber or trees to the present situation, some of the factors to be looked at include:

- whether the nature and scope of the unit chosen is reasonable and practical;
- whether it reflects all the physical damage caused by the casualty;
- whether it remains constant and identifiable for tax purposes, and has a cost or adjusted basis that is not changed except by elimination of an asset or by injection of capital;
- whether it is consistent with the taxpayer's other tax accounting practices (for example, depletion in the timber cases);
- whether it is accounted for and identifiable as a unit for non-tax accounting purposes;
- whether it is a unit whose utility derives from its functioning as a whole;
- whether it is separately treated for operational and management purposes;

- whether it is a "commercially segmentable" unit likely to be bought or sold as such; and
- whether it is consistent with industry practice.

In applying these factors, we should take into account the purpose of the "single, identifiable property" rule, which is to arrive at a logical, reasonable, and practical unit for valuation and accounting purposes, while preventing the borrowing of basis from unharmed property, without segregating the damaged property into artificially small subunits. We will discuss the application of these factors to the parties' alternate positions.

Reasonable and practical in nature and scope

Taxpayer's primary position is that the "single, identifiable property" damaged by is each of its wire centers. A wire center consists of the central office building itself; central office equipment (including, but not limited to the cosmic frame, switching equipment, routers, digital subscriber line access multiplexer equipment, routers, collocation equipment, the cabling room and fiber optic circuitry); and wiring and other outside plant assets (including, but not limited to, copper and fiber cables, fiber optic circuitry, remote terminals, cross connections, conduits, ducts, poles, towers, repeaters, rectifiers, amplifiers, serving terminals, and customer connection equipment). We believe that this extensive aggregation of assets is not a reasonable "single, identifiable property," and that this position does not comply with the regulations under § 165. In terms of this factor, use of the entire wire center is not of a nature and scope that make practical sense, and permits too much "borrowing" of basis from undamaged assets.

For example, under the regulations a building is the prime example of a single, identifiable property. Illustrating the "single, identifiable property" rule, § 1.165-7(b)(2)(i) provides that in determining the decrease in value where casualty damage has occurred to a building and ornamental or fruit trees used in a trade or business, the decrease in value "shall be measured by taking the building and trees into account separately, and not together as an integral part of the realty, and separate losses shall be determined for such building and trees." Similarly, basis is determined separately for the building, the realty, and the ornamental plantings. See § 1.165-7(b)(3), Ex. (2). Under the regulations, only in the case of property held for personal use can a building be aggregated and combined with the underlying realty and related assets such as ornamental plantings. See § 1.165-7(b)(2)(ii), (iii) Ex. (3).

This treatment of a commercial building as a separate "single, identifiable property" under the regulations has been upheld by the courts. See Keefer v. Commissioner, 63 T.C. 596 (1975): United States v. Koshland, 208 F. 2d 636 (9th Cir. 1953). Yet Taxpayer in the present case argues that a wire center building should be combined not only with its entire contents, but also with an extensive collection of outside plant assets—an aggregation far larger than that permitted to nonbusiness, noninvestment

taxpayers under § 1.165-7, and potentially involving much more "borrowing" of basis than was permitted in Keefer and Koshland. Taxpayer has advanced no compelling reason why the regulations should not be followed here.

Taxpayer's aggregation of inside and outside assets, along with the building, is too broad. In determining a casualty loss for damaged outside property, Taxpayer should not be able to draw basis from untouched property located within its central office, and vice versa. It is common for there to be significant casualty damage to outside plant assets, and little or no damage to the building, or to assets housed within the building. Similarly, a casualty may generally damage the building and central office equipment, while leaving outside plant property largely or completely untouched. These distinctions are reflected in Taxpayer's classification of its assets for

The examination team agrees that identification of a wire center is part of the analysis of the appropriate "single, identifiable property," but believes that further subdivision is appropriate. The field's primary position is that each FCC subaccount for each wire center should be regarded as the "single, identifiable property" damaged or destroyed by the casualties. Its alternative position is to divide the wire center into inside plant and outside plant, and within those categories to divide inside plant into building, main distributing frames, switching equipment, transmission equipment, and power equipment, and outside plant property into each feeder cable and each distribution area or equivalent. The field has also indicated that it would accept a subdivision of a wire center based on Taxpayer's of its of telecommunications assets; in addition to asset groupings as to which the parties agree, this would include building, central office equipment, and outside plant property.

While we agree that it is reasonable to subdivide the wire center into building, central office equipment, and outside plant property, we do not feel that further subdivision is necessary in order to achieve the purposes of the "single, identifiable property" rule in this situation. For example,

thus, the basis in all or most of the inside plant assets will be available in any case. Similarly,

. In both cases, therefore, subdivision into building, central office equipment, and outside plant property will restrict "borrowing" from unharmed assets, while still reflecting all the damage caused by the casualty, another factor cited in the case law.[14] Under this intermediate

[14] We assume that these subdivisions are applied in a reasonable manner, not in a rigid fashion. It would not be reasonable, for example, if minor damage to outside plant property, from that

approach, which reflects the Rinaldi court's observation that the units chosen "be of a nature and scope that make practical sense," 38 Fed. Cl. at 355, there is a correspondence between the areas and functions affected by the casualty and the units used to measure the effect of the casualty for tax purposes.

Functional, operational, and management factors

Taxpayer is in the business of providing telecommunications services. Taxpayer argues that the smallest grouping of assets needed to provide “two-way communication, which is what a telecommunication company provides to its local customers,” is the wire center, and as such, should be considered the functional unit. Taxpayer cites to the case of the logging road and rail systems at issue in Weyerhaeuser for the proposition that the purpose of § 165 is not to limit the casualty loss deduction to the smallest possible element of Taxpayer’s property, and notes that the logging networks, like wire centers, served a "specific and limited territory." See 32 Fed. Cl. at 106.

We do not agree that the functional unit for purposes of § 165 is necessarily the smallest grouping of assets needed to provide a good or service. As discussed above, the example in the regulations treats a taxpayer's ornamental plantings outside a commercial building as assets separate from the building and the realty, even though presumably the plantings, by themselves, do not provide a good or service in the taxpayer's operation. See § 1.165-7(b)(3), Ex. (2). Similarly, in Weyerhaeuser the taxpayer divided its property into units that, by themselves, were not capable of providing a good or service to the taxpayer's customers; a logging road system is not useful without timber to log, yet the road networks were not combined with the timber stands they served as aggregate "single, identifiable properties." In both the regulation and the case, the units chosen served a discrete function within the taxpayers' overall operation.

With respect to the field's primary position, we do not feel that FCC subaccounts are generally groupings "whose utility as assets derive from their functioning as a whole." Weyerhaeuser, 32 Fed. Cl. at 104; see also Rinaldi, 38 Fed. Cl. at 354-55 (citrus grove as "realistic economic unit"). A collection of similar assets, such as all poles within a wire center, is not a functional unit, even though it may be identified and accounted for separately for regulatory purposes.

The field's alternate position, which subdivides inside and outside plant into further functional units, is generally more consistent with the identification of function in the case law as a factor to be considered. For example, feeder cables extend between the central office or digital loop carrier remote terminals and the distribution facilities. are used to measure and forecast cumulative demand and capacity, as are areas. Similarly, grouping of central office equipment into

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primarily affected inside plant, "unlocked" all the basis in outside plant property for use in the casualty-loss computation.

distribution, switching, transmission, and power equipment is a functional breakdown that is consistent with Taxpayer's own . There is no evidence, however, that each of these inside plant equipment subgroupings is managed as a separate unit.

In telecommunications, as in most businesses, there are many functional groupings of property: larger systems, such as a wire center, are in turn composed of smaller groupings of assets, each of which is a discrete "system" of components that has its own function. We recognize that a wire center operates in many respects as a functional unit; however, we believe that it can reasonably be divided into smaller functional groupings. Specifically, the central office building, as a unit, serves to house and protect the equipment within the building. We agree with the field that the building is a "single, identifiable property" separate from other inside plant assets. The central office equipment works together as the principal control point of the wire center, connecting customers to other customers within the exchange area and to customers outside that area.[15] The outside plant property comprises a number of assets that can be configured in various ways depending on the individual characteristics of a wire center (size, population, etc.). However, as a whole the outside plant property provides one main function, to transmit information between the central office and the end user.

Similarly, while many management decisions are made at the wire center level, the record shows that a significant number of management decisions involve primarily outside plant property. For example,

These factors indicate that separate treatment of the central office building, the central office equipment, and the outside plant property is appropriate.

Consistent with tax and nontax accounting practice; basis constant and identifiable

[15] We do not mean to imply that all the equipment housed in a building is always one "single, identifiable property." Depending on the nature of the casualty and other factors, further subdivision may be appropriate. For example, if a casualty affected only certain functional subgroups of equipment and left others unharmed, this could be a factor supporting separate treatment.

Taxpayer's asset accounting, for both tax and nontax purposes, is based on . Because most information reporting is aggregated at a level for regulatory purposes, tax accounting records are kept at the and by . Taxpayer uses these asset classes to compute depreciation for tax purposes, although it depreciates on . Taxpayer's depreciation for and purposes is also maintained at the level.

To determine its basis in a wire center, Taxpayer identified all of the asset accounts that included components of the damaged wire center. It then determined the percentage of the components in each of those accounts attributable to the damaged wire center, and allocated a portion of the total basis in those accounts to the wire center using the percentage. Taxpayer agrees that, using USoA subaccounts within a wire center, it can similarly determine the basis attributable to the building, the central office equipment, and the outside plant property separately. However, Taxpayer asserts that it could not use this methodology to determine the basis attributable to certain further subgroupings of assets, such as distribution areas, since it

The smallest possible "single, identifiable property" that has an identifiable basis and would be consistent with Taxpayer's tax and nontax accounting practices would be the individual asset. However, considering the other factors under the case law, we agree with both Taxpayer and the field that Taxpayer is not required to quantify its casualty losses on an individual-asset basis.

Taxpayer argues that the wire center, , is

Taxpayer argues that this is consistent with general industry practice, and that wire centers, as geographic areas, remain relatively stable as populations grow or shift.

We recognize the significance of the wire center as an or territory; however, we do not believe that this precludes a reasonable subdivision of wire center assets for purposes of determining the amount of a casualty loss. While the wire center remains relatively stable, as a geographic area, the mix of assets that comprise the wire center, and the basis of those assets, will of course vary over time. For FCC purposes, within that wire center area Taxpayer

.[16] The field's primary position, treating each FCC subaccount within a wire center as a "single, identifiable property," is also consistent with Taxpayer's accounting; in fact, it is . The FCC subaccount remains constant and identifiable, and the USoA accounting system is used throughout the industry. However, in terms of the other factors to be considered, FCC subaccounts such as all poles or all switches in a wire center do not necessarily represent functional, operational, or commercially segmentable units.

With respect to the field's alternate position, Taxpayer argues that some of the functional asset groupings suggested by the field do not have an "identifiable basis" within the meaning of the case law, and do not represent a practical approach to the casualty loss determination. Taxpayer asserts, for example, that it could not easily or accurately determine the basis attributable to distribution areas and equivalent serving areas, since these areas vary in size and asset composition and it does not maintain its accounts on that basis for regulatory, financial, or tax purposes.

In terms of Taxpayer's tax accounting practices, a division into building, central office equipment, and outside plant is generally consistent with how Taxpayer , which reflects the FCC/USoA system. For example, a wire center building is categorized separately under Rev. Proc. 87-56, as asset class 48.11. See also asset classes 48.12 and 48.121, which include central office equipment, and 48.14, which groups together "pole lines, cable, aerial wire, underground conduits" and comparable outside plant property.

Consistency with how a taxpayer accounts for its assets in other tax contexts is a factor in the "single, identifiable property" determination, but is not dispositive. We agree with both the field and Taxpayer that given the specific language and function of § 1.165-7(b), the "single, identifiable property" for purposes of calculating a casualty loss is not necessarily the same as the unit of property for another tax purpose. For example, we considered whether it would be reasonable for Taxpayer to use, as the "single, identifiable property" for § 165 purposes, the unit of property used or proposed by Taxpayer for purposes of determining whether an expenditure is a repair, deductible under § 162, or a replacement or betterment that should be capitalized under § 263.[17] For a number of reasons, however, we concluded that such conformity was neither required nor appropriate on these facts.

On balance, these factors support a breakdown of wire center assets into central office building, central office equipment, and outside plant property -- a subdivision that is consistent with categories Taxpayer uses for regulatory, financial, and tax accounting purposes.

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17 See, e.g., Fedex Corp. v. United States, 291 F. Supp. 2d (W.D. Tenn. 2003), aff'd, 412 F.3d 617 (6th Cir. 2005).

Commercially segmentable

Sales of wire centers have occurred over the years. Neither Taxpayer, nor any other wireline telecommunications company, generally buys or sells smaller existing or “in place” components of a wire center.

It is possible for a company to be a local exchange carrier without owning an entire wire center.

. Unbundled network elements together make up a loop that connects to a digital subscriber line access multiplexer or a voice switch (or both). The loop allows non-facilities-based telecommunications providers to deliver service without laying network infrastructure. Taxpayer argues, however, that this does not mean that its wire centers are commercially segmentable into loops or other subunits, since

On balance, this factor tends to support Taxpayer's choice of the wire center as the "single, identifiable property." However, it is only one of several factors that are taken into account, and is not dispositive. As discussed earlier, under the § 165 regulations a commercial building is considered a "single, identifiable property" separate from the land beneath it, and the ornamental plantings surrounding it, although it is unlikely that either the building or the ornamental plantings would be sold as a commercial unit separate from each other or the underlying realty. Similarly, in Weyerhaeuser the taxpayer's logging road networks were considered separate "single, identifiable properties," although they would not typically be sold as an economic unit separate from the timber tracts they serve.

Summary

For the foregoing reasons, we conclude that a subdivision of the assets in a wire center into the central office building itself, central office equipment, and outside plant—a grouping that is consistent with the § 165 regulations, reasonable in relation to the nature and scope of the casualties Taxpayer experienced, and generally consistent with how Taxpayer classifies its assets for regulatory, financial, and tax accounting purposes—is a reasonable means of identifying the "single, identifiable properties" for purposes of determining the amount of Taxpayer's casualty losses under §§ 165 and 1.165-7.

CAVEAT:

A copy of this technical advice memorandum is to be given to the taxpayer. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.