Internal Revenue Service

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Department of the Treasury
Washington, DC 20224

Third Party Communication: None
Date of Communication: Not Applicable

Person To Contact:
, ID No.
Telephone Number:

Refer Reply To:
CC:ITA:B06
PLR-111450-10

Date:
June 08, 2010

Legend:

Parent =
S =
Date 1 =
Date 2 =
Target =

Dear :

Parent's authorized representative is requesting a ruling under § 1.381(c)(5)-1(d)(1)(i) of the Income Tax Regulations on behalf of S, one of Parent's subsidiaries. S is requesting the Commissioner's consent to change to a method other than the principal method of accounting. Specifically, S is requesting consent to change its method of identifying and allocating costs under § 263A of the Internal Revenue Code and the regulations thereunder, for the taxable year ending Date 1. S uses an overall accrual method of accounting.

On Date 2, S merged into Target in a transaction to which § 381(a) applies. The operations of S and Target were not operated as separate and distinct trades or businesses immediately after Date 2. On Date 2, the fair market value of the inventory held by S was greater than the fair market value of inventory held by Target, requiring S to use its methods as the principal methods of identifying and allocating costs under § 263A. *See* § 1.381(c)(5)-1(c)(2). S will use the principal method to capitalize the direct cost of property acquired for resale, except freight-in. However, S is not permitted to continue to use all of the principal methods of identifying and allocating costs under § 263A, because some of those methods do not clearly reflect S's income. *See* § 1.381(c)(5)-1(c)(1)(i). Accordingly, S has requested a private letter ruling under § 1.381(c)(5)-1(d)(1)(i) to use other methods.

S requests that the Commissioner allow it to capitalize all costs required to be capitalized under § 263A and the regulations thereunder including freight-in, purchasing costs, quality control and inspection costs, capitalizable mixed service and administrative costs, and book/tax differences relating to capitalizable costs. S also requests that it be allowed to discontinue capitalizing costs that are not required to be capitalized under § 263A and the regulations thereunder. These costs include product certification costs required as a condition of sale and certain selling costs. In addition, S requests that it be allowed to use the *de minimis* rule described in § 1.263A-1(g)(4)(ii) to determine if any portion or all of a mixed service department's costs are allocable to property acquired for resale. Additionally, S requests that it be allowed to use the simplified service cost method with the labor-based allocation ratio to determine capitalizable mixed service costs for those mixed service departments that are not treated as engaged exclusively in resale or non-resale activities under the *de minimis* rule (because 90 percent or more of the department's costs are not capitalizable service costs or deductible service costs). *See* § 1.263A-1(h)(4). S also requests that it be allowed to use the 1/3-2/3 rule to allocate labor costs of personnel engaged in both purchasing and non-purchasing activities between these activities. *See* ' 1.263A-3(c)(3)(ii)(A). Finally, S requests that it be allowed to use the simplified resale method without the historic absorption ratio election to capitalize additional § 263A costs to ending inventory. *See* § 1.263A-3(d)(3). In using the simplified resale method, S requests that the costs not presently capitalized be treated as additional § 263A costs.

Section § 1.263A-1(g)(4)(ii) provides that if 90 percent or more of a mixed service department's costs are service costs that do not directly benefit or are not incurred by reason of the performance of production or resale activities (deductible service costs), the taxpayer will not allocate any portion of the service department's costs to property produced and property acquired for resale during the taxable year. If 90 percent or more of a mixed service department's costs are service costs that directly benefit or are incurred by reason of the performance of production or resale activities (capitalizable service costs), the taxpayer will allocate 100 percent of the department's costs to the property produced and property acquired for resale during the taxable year. The taxpayer will use reasonable factors or relationships to determine whether 90 percent or more of a mixed service department's costs are deductible service costs or capitalizable service costs.

Section 1.263A-1(h)(4) permits the use of the simplified service cost method with the labor-based allocation ratio for determining capitalizable mixed service costs incurred during the taxable year with respect to eligible property.

Section 1.263A-3(c)(3)(ii)(A) provides that a taxpayer may use the 1/3-2/3 rule to allocate labor costs of personnel engaged in both purchasing and non-purchasing activities between these activities. Under this rule, if less than one-third of a person's activities are related to purchasing, none of that person's labor costs are allocated to

purchasing; if more than two-thirds of a person's activities are related to purchasing, all of that person's labor costs are allocated to purchasing; and in all other cases, the taxpayer must reasonably allocate labor costs between purchasing and non-purchasing activities.

Section 1.263A-3(d)(3) permits the use of the simplified resale method without the historic absorption ratio election for determining the additional § 263A costs properly allocable to property acquired for resale and other eligible property on hand at the end of the taxable year.

The Commissioner has determined that the appropriate method for S to use for identifying and allocating costs under § 263A is the method that S requested. Accordingly, the Commissioner under § 1.381(c)(5)-1(d)(1)(i) grants S consent to capitalize all costs required to be capitalized under § 263A and the regulations thereunder including freight-in, purchasing costs, quality control and inspection costs, capitalizable mixed service and administrative costs, and book/tax differences relating to capitalizable costs; to discontinue capitalizing costs that are not required to be capitalized under § 263A and the regulations thereunder including product certification costs required as a condition of sale and certain selling costs; to use the *de minimis* rule described in § 1.263A-1(g)(4)(ii) to determine if any portion or all of a mixed service department's costs are allocable to property acquired for resale; to use the simplified service cost method with the labor-based allocation ratio to determine capitalizable mixed service costs for those mixed service departments that are not treated as engaged exclusively in resale or non-resale activities under the *de minimis* rule; to use the 1/3-2/3 rule to allocate labor costs of personnel engaged in both purchasing and non-purchasing activities between these activities; and to use the simplified resale method without the historic absorption ratio election to capitalize additional § 263A costs to ending inventory with costs not presently capitalized treated as additional § 263A costs.

Pursuant to § 1.381(c)(5)-1(e)(4), S will compute the adjustment necessary to reflect the change in the method of identifying and allocating § 263A costs. S will take the adjustment into account in computing taxable income in the taxable year that includes Date 2.

Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter. We express no opinion as to whether specific departments and their associated costs are capitalizable, mixed service, or deductible departments or costs. We express no opinion regarding the propriety of the factors or relationships used to determine whether 90 percent or more of a mixed service department=s costs are deductible service costs or capitalizable service costs under the *de minimis* rule described in ' 1.263A-1(g)(4)(ii). We express no opinion regarding the propriety of S's method of determining the amount of a person's activities related to purchasing under

the 1/3-2/3 rule described in ' 1.263A-3(c)(3)(ii)(A). We also express no opinion as to whether a particular cost is capitalizable under § 263A and the regulations thereunder. Additionally, we express no opinion as to whether § 381 applies, that the methods used by S on Date 2 were the principal methods of accounting under § 1.381(c)(5)-1(c)(2), and that the methods for identifying and allocating costs failed to clearly reflect S's income after Date 2. These determinations are to be made by the director in connection with the examination of Parent's federal income tax returns.

This ruling is directed only to Parent. Section 6110(k)(3) provides that it may not be used or cited as precedent.

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to Parent's authorized representatives.

A copy of this letter must be attached to any income tax return to which it is relevant. Alternatively, if Parent is filing its federal income tax return electronically it may satisfy this requirement by attaching a statement to its return that provides the date and control number of the letter ruling.

The rulings contained in this letter are based upon information and representations submitted by Parent and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the material submitted in support of the request for rulings, it is subject to verification on examination.

Sincerely,

Roy A. Hirschhorn
Branch Chief, Branch 6
(Income Tax & Accounting)