DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

OFFICE OF THE CHIEF COUNSEL

March 12, 2012

Number: **2012-0013**
Release Date: 3/30/2012

CC:ITA:B03
GENIN-107083-12

UIL: 263.00-00

Dear :

I am responding to your letter, dated February 02, 2012, regarding the proposed and temporary regulations recently issued by this office on the Deduction and Capitalization of Expenditures Related to Tangible Property, 76 Fed. Reg. No. 248, 81060-131 (Dec. 27, 2011). Specifically, you expressed concern over the potential retroactive impact of these proposed and temporary regulations under sections 162(a) and 263(a) of the Internal Revenue Code, addressing amounts paid to acquire, produce, or improve tangible property.

As stated in the preamble, the proposed and temporary regulations clarify and expand the standards under sections 162(a) and 263(a) and provide certain bright-line tests (for example, a de minimis rule for certain acquisition costs) for applying these standards. In general, the temporary regulations are effective prospectively for amounts paid or incurred in taxable years beginning on or after January 1, 2012. In addition, certain provisions of the temporary regulations (for example, the de minimis rule under § 1.263(a)-2T(g)) are only effective for amounts paid or incurred to acquire or produce property beginning on or after January 1, 2012.

Any change in treatment of an item to conform to the temporary regulations is a change in method of accounting. See § 1.446-1(e)(2)(ii)(a). Accordingly, a taxpayer is required to take into account an adjustment under section 481(a) to prevent amounts from being duplicated or omitted when the taxpayer's taxable income is computed under a method of accounting different from the method used to compute taxable income for the preceding taxable year. The IRS and Treasury Department have issued Rev. Proc. 2012-19 and Rev. Proc. 2012-20 to ease the transition to the new rules by providing automatic consent for taxpayers that want to change to the methods of accounting provided in the temporary regulations for taxable years beginning on or after the effective date. The IRS is also considering additional means of easing the transition to the new regulations.

Your letter also expressed concern regarding the factual nature of many inquiries under the temporary regulations and noted that the previously requested that the IRS consider using the Industry Issue Resolution (IIR) program to address the application of sections 162(a) and 263(a) to retail industry specific issues. As you are aware, your initial IIR request was set aside pending the issuance of the proposed and temporary regulations. Our office expected that these regulations would provide a framework and standards that would be useful for analyzing the treatment of many different costs, including the types of costs incurred in your industry. Now that the proposed and temporary regulations have been issued, we understand that you have had discussions with IRS personnel regarding your IIR request. Our office believes that the IIR process is a valuable tool in helping to develop clear and administrable rules that deal with industry-specific factual situations, and we look forward to working with you and LB&I on the consideration of your updated request.

Finally, you note that the continues to have concerns regarding certain rules set out in the proposed and temporary regulations. As you know, before these regulations are adopted as final regulations, consideration will be given to any written comments submitted to the IRS and Treasury Department. In addition, a public hearing on the regulations is scheduled for May 9, 2012. We welcome your written comments and your participation in the public hearing.

I hope this information has been helpful. If you have any questions, please contact me or , Senior Counsel, in my office at .

Sincerely,

Christopher F. Kane
Chief, Branch 3
Office of Associate Chief Counsel
(Income Tax & Accounting)