OFFICE OF
CHIEF COUNSEL

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

October 3, 2001

Number: **200203009**
Release Date: 1/18/2002
CC:PSI:6:
TL-N-4252-00
UILC: 168.20-00

INTERNAL REVENUE SERVICE NATIONAL OFFICE FIELD SERVICE ADVICE

MEMORANDUM FOR INDUSTRY COUNSEL (GAMING)
LAS VEGAS

FROM: Kathleen Reed, Senior Technician Reviewer, Branch 6, Office of Passthroughs and Special Industries, CC:PSI:6

SUBJECT: Recovery period for various components of a hotel/casino complex

This Chief Counsel Advice responds to your memorandum dated April 30, 2001. In accordance with section 6110(k)(3) of the Internal Revenue Code, this Chief Counsel Advice should not be cited as precedent.

LEGEND

Taxpayer =

b =

c =

d =
e =

f =

ISSUES

1. Whether tangible personal property used in connection with a hotel/casino complex is includible in asset class 57.0, Distributive Trades and Services, of Rev. Proc. 87-56, 1987-2 C.B. 674, or asset class 79.0, Recreation?

2. Whether various facades, ceilings, wall coverings, millwork, decorative lighting fixtures, kitchen equipment hookups and guest room electrical outlets, emergency

power generators, and door locks of the hotel/casino complex are section 1245 property or section 1250 property for depreciation purposes?

3. Whether site utilities at the hotel/casino complex are depreciated as part of the complex or as land improvements?

4. Whether an outdoor pylon sign is depreciated over 15 years as a land improvement?

CONCLUSIONS

1. Tangible personal property used in connection with a hotel/casino complex is includible in asset class 57.0 or asset class 79.0 in accordance with the activity in which it is primarily used.

2. The exterior facades, ceilings, guest room electrical outlets, and door locks of Taxpayer's hotel/casino complex are section 1250 property for depreciation purposes. The wall coverings, millwork, decorative lighting fixtures, kitchen equipment hookups, and emergency power generators at issue in the present case are section 1245 property for depreciation purposes. However, if it can be determined that a percentage of Taxpayer's emergency power generators' output is attributable to building operations, a functional allocation would be appropriate.

3. Site utilities at the hotel/casino complex relate to the overall operation and maintenance of the complex and are depreciated as part of the complex.

4. The outdoor pylon sign is a land improvement. A portion of the sign may qualify as section 1245 property.

FACTS

Taxpayer owns and operates an elaborate hotel/casino complex that it placed in service in b. The complex cost approximately $d million to construct, exclusive of land and pre-opening costs. Of that amount, $e million is being recovered through depreciation over a 5-year recovery period. The taxable years at issue are b and c.

The complex is designed to evoke an extravagant, f ambiance and, in addition to gambling facilities, offers dining, live entertainment, a shopping promenade, swimming pools, a health spa, wedding and banquet facilities, a 1200-seat theater, and over 3000 hotel rooms. During the complex's first 18 months of operation, approximately half of its net operating revenues was derived from non-casino activities.

Several categories of construction costs are at issue in the present case. These categories are described briefly below.

1. Facades

Decorative facades provide the exterior wall covering of the hotel/casino complex.

2. Ceilings

This category includes dropped or lowered ceilings with decorative finishes.

3. Wall coverings

The wall coverings at issue consist of strippable wall paper and vinyl.

4. Millwork

This category includes molding, trim, paneling, and finish carpentry located throughout the hotel/casino complex.

5. Lighting

At issue are the costs of various types of lighting fixtures, including chandeliers, wall sconces, down lighting, neon lighting, column lights, theater lighting, and the costs of the wiring and electrical connections associated with these fixtures.

6. Kitchen equipment hookups and guest room electrical outlets

This category encompasses the electrical distribution system of the kitchen as well as electrical outlets located in guest rooms and guest bathrooms.

7. Generators

Two emergency power generators provide power for emergency/safety systems and casino operations.

8. Door locks

Each hotel guest room has a computerized door lock. Guests receive key cards with entry codes recorded on the magnetic stripes.

In addition to the categories of construction costs described above, costs attributable to Taxpayer's site utilities and a large outdoor pylon sign are at issue in

the present case. Site utilities are the systems that are used to distribute city-furnished utility services from Taxpayer's property line to the hotel/casino complex (building) line. Water, sewer, and gas services are connected to the building by underground piping. Electric service is connected by overhead or underground lines. The outdoor pylon sign consists of a superstructure and a television-like message center.

LAW AND ANALYSIS

Issue 1

Section 167(a) of the Internal Revenue Code provides a depreciation allowance for the exhaustion, wear and tear of property used in a trade or business or held for the production of income.

The depreciation deduction provided by section 167(a) for tangible property placed in service after 1986 generally is determined under section 168. This section prescribes two methods of accounting for determining depreciation allowances: (1) the general depreciation system in section 168(a); and (2) the alternative depreciation system in section 168(g). Under either depreciation system, the depreciation deduction is computed by using a prescribed depreciation method, recovery period, and convention.

For purposes of either section 168(a) or 168(g), the applicable recovery period is determined by reference to class life or by statute. Section 168(i)(1) provides that the term "class life" means 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 it were in effect and the taxpayer were an elector. Prior to its revocation, section 167(m) provided that in the case of a taxpayer who elected the asset depreciation range system of depreciation, the depreciation deduction would be computed based on the class life prescribed by the Secretary which reasonably reflects the anticipated useful life of that class of property to the industry or other group.

Section 1.167(a)-11(b)(4)(iii)(b) of the Income Tax Regulations sets out the method for asset classification under former section 167(m). Property is included in the asset guideline class for the activity in which the property is primarily used. Property is classified according to primary use even though the use is insubstantial in relation to all of the taxpayer's activities.

Rev. Proc. 87-56 sets forth the class lives of property that are necessary to compute the depreciation allowances under section 168. The revenue procedure establishes two broad categories of depreciable assets: (1) asset classes 00.11 through 00.4 that consist of specific assets used in all business activities; and (2) asset classes 01.1 through 80.0 that consist of assets used in specific business

activities. The same item of depreciable property can be described in both an asset category (that is, asset classes 00.11 through 00.4) and an activity category (that is, asset classes 01.1 through 80.0), in which case the item is classified in the asset category. See Norwest Corporation & Subsidiaries v. Commissioner, 111 T.C. 105 (1998) (item described in both an asset and an activity category (furniture and fixtures) should be placed in the asset category). The business activity asset classes described below are set forth in Rev. Proc. 87-56.

Asset class 57.0, Distributive Trades and Services, includes assets used in wholesale and retail trade, and personal and professional services. Assets in this class have a recovery period of 5 years for purposes of section 168(a) and 9 years for purposes of section 168(g).

Asset class 79.0, Recreation, includes assets used in the provision of entertainment services on payment of a fee or admission charge, as in the operation of bowling alleys, billiard and pool establishments, theaters, concert halls, and miniature golf courses. Assets in this class have a recovery period of 7 years for purposes of section 168(a) and 10 years for purposes of section 168(g).

The Standard Industrial Classification Manual (SIC) published by the Office of Management and Budget can provide insight into the content of the asset classes described in Rev. Proc. 87-56. Care must be exercised because SIC does not make use of the same classification techniques and depreciation concepts of Rev. Proc. 87-56. While SIC has precise categorization by primary business activity using language very similar to that found in Rev. Proc. 87-56, the revenue procedure departs dramatically from the categorization scheme of SIC by establishing two broad categories of depreciable assets: (1) asset classes 00.11 through 00.4 that consist of specific assets used in all business activities; and (2) asset classes 01.1 through 80.0 that consist of assets used in specific business activities. However, the asset class numbers for the specific business activities described in Rev. Proc. 87-56 are largely taken from SIC.

SIC category 7011 includes establishments furnishing lodging and meals for the general public, such as hotels and motels. Former asset class 70.2, Personal and Professional Services, included assets used in the provision of personal services, such as those offered by hotels and motels. Asset class 57.0 was established by Rev. Proc. 80-15, 1980-1 C.B. 818. The revenue procedure provides that asset class 57.0 includes assets formerly included in asset class 70.2. Assets used by taxpayers engaged in hotel operations are includible in asset class 57.0.

SIC categories 7993 and 7999 include establishments engaged in operating various gaming devices and casinos. The Tax Court has characterized legal gaming as entertainment. Libutti v. Commissioner, T.C. Memo. 1996-108. Assets used by taxpayers engaged in gaming activities are includible in asset class 79.0.

Under section 1.167(a)-11(b)(4)(iii)(b), assets are classified according to the activity they are primarily used in, regardless of whether the activity is insubstantial in relation to all the taxpayer's activities. Thus, a taxpayer, for depreciation purposes, may be engaged in more than one activity. If a taxpayer uses assets in more than one activity, the assets are classified according to the activity in which they are primarily used.

In the present case, Taxpayer is engaged in two business activities--casino operations and hotel operations. Taxpayer's section 1245 assets are classified, for depreciation purposes, in accordance with the activity in which they are used. Assets used by Taxpayer's in its casino operations are includible in asset class 79.0. Assets used by Taxpayer's in its hotel operations are includible in asset class 57.0. If a particular asset is used in both activities, the cost of the asset is not allocated between the two activities. Rather, the total cost of the asset will be classified for depreciation purposes according to the activity in which the asset is primarily used. Section 1.167(a)-11(b)(4)(iii)(b). This determination may be made in any reasonable manner.

Rev. Proc. 62-21, 1962-2 C.B. 418, is a predecessor of Rev. Proc. 87-56. Rev. Proc. 62-21 states that the guideline lives set forth therein apply to broad classes of assets rather than to individual assets. Supplement II, 1963-2 C.B. 744, which consists of Questions and Answers, was published to assist taxpayers in applying Rev. Proc. 62-21. Answer 78 provides a primary use rule for the classification of assets used in more than one business activity similar to the rule found in section 1.167(a)-11(b)(4)(iii)(b). Answer 78 further provides that primary use may be determined in any reasonable manner. We note that in Rev. Proc. 97-10, 1997-1 C.B. 628, either a gross receipts test or a square footage test was used to determine whether a building is primarily used as a retail motor fuels outlet.

Issues 2, 3, and 4

The recovery period of nonresidential real property is established by statute. Nonresidential real property has a recovery period of 39 years (or 31.5 years if the property was placed in service before May 13, 1993) for purposes of section 168(a) and 40 years for purposes of section 168(g). Sections 168(c) and 168(g)(2)(c). Section 168(e)(2)(B) defines "nonresidential real property" as section 1250 property which is not residential rental property or property with a class life of less than 27.5 years.

Section 168(i)(12) provides that the term "section 1250 property" has the same meaning as given by section 1250(c). Section 1250(c) provides that section 1250 property is any real property, other than section 1245 property, which is or has been of a character subject to the allowance for depreciation provided in section 167. Section 1245(a)(3) provides that "section 1245 property" includes any

property that is of a character subject to the allowance for depreciation under section 167 and is personal property. Section 1.1245-3(b) provides that “personal property” includes tangible personal property as defined in section 1.48-1(c) (relating to the definition of “section 38 property” for purposes of the investment tax credit). Section 1.48-1(c) provides that “tangible personal property” means any tangible property except land and improvements thereto, such as buildings or other inherently permanent structures (including items which are structural components of such buildings or structures). Tangible personal property includes all property (other than structural components) which is contained in or attached to a building.

Section 1.48-1(e)(1) defines a “building” as any structure or edifice enclosing a space within its walls, and usually covered by a roof, the purpose of which is, for example, to provide shelter or housing or to provide working, office, parking, display, or sales space. The term includes, for example, structures such as apartment houses, factory and office buildings, warehouses, barns, garages, railway or bus stations, and stores. Such term includes any such structure constructed by, or for, a lessee even if such structure must be removed, or ownership of such structure reverts to the lessor, at the termination of the lease.

Section 1.48-1(e)(2) provides that the term "structural components" includes such parts of a building as walls, partitions, floors, and ceilings, as well as any permanent coverings therefor such as paneling or tiling; windows and doors; all components (whether in, on, or adjacent to the building) of a central air conditioning or heating system, including motors, compressors, pipes and ducts; plumbing and plumbing fixtures, such as sinks and bathtubs; electric wiring and lighting fixtures; chimneys; stairs, escalators, and elevators, including all components thereof; sprinkler systems; fire escapes; and other components relating to the operation or maintenance of a building. The section also provides that the term “structural components” does not include machinery the sole justification for the installation of which is the fact that such machinery is required to meet temperature or humidity requirements which are essential for the operation of other machinery or the processing of materials or foodstuffs.

Senate Report 1881, 1962-3 C.B. 707, 722, which accompanied the Revenue Act of 1962, states that tangible personal property includes assets accessory to a business. Senate Report 95-1263, 1978-3 C.B. (Vol.1) 315, 415, which accompanied the Revenue Act of 1978, states that tangible personal property includes special lighting (including lighting to illuminate the exterior of a building or store, but not lighting to illuminate parking areas), false balconies, and other exterior ornamentation that have no more than an incidental relationship to the operation or maintenance of a building, and identity symbols that identify or relate to a particular retail establishment or restaurant such as special materials attached to the exterior or interior of a building or store and signs (other than billboards). Similarly, the Senate Report stated that property eligible for the investment tax

credit under prior law included floor coverings which are not an integral part of the floor itself, such as floor tile generally installed in a manner to be readily removed (that is, it is not cemented, mudded, or otherwise permanently affixed to the building floor but, instead, has adhesives applied which are designed to ease its removal), carpeting, wall panel inserts such as those designed to contain condiments or to serve as a framing for pictures of the products of a retail establishment, beverage bars, ornamental fixtures (such as coats-of-arms), artifacts (if depreciable), booths for seating, movable and removable partitions, and large and small pictures of scenery, persons, and the like which are attached to walls or suspended from the ceiling.

The structural components provisions of the regulations, as well as the Senate Reports cited above, have been considered by the courts in a great number of cases, some of which are discussed below.

Morrison, Inc.v. Commissioner, T.C. Memo. 1986-129, considered whether various items of property in the taxpayer's cafeterias were tangible personal property. Among the items considered were emergency lighting, decorative lighting, lattice millwork, and decor window treatments. The court held that the emergency lighting and decorative lighting fixtures were distinguishable from the lighting fixtures specifically mentioned in the regulations as structural components because they did not provide basic illumination in the cafeterias. Citing Senate Report 95-1263, the court found the decorative lighting, lattice millwork, and decor window treatments to be decorative components that related only incidentally to the operation or maintenance of the buildings.

In its consideration of whether various items in the taxpayer's buildings were tangible personal property, the court in Metro National Corp. v. Commissioner, T.C. Memo. 1987-38, found that the structural components listed in section 1.48-1(e)(2) share the common characteristic of reasonable permanency. The court stated that ordinarily a building is designed and constructed with the expectation that the components listed in the regulation will remain in place indefinitely, and that such components are usually integrated with the building during the construction phase. In determining whether a particular item was a structural component, the court looked to whether the item was incorporated in the original plan, design, and construction of the building.

In Scott Paper Co., 74 T.C.137, 183, the Tax Court focused on the last sentence of section 1.48-1(e)(2) of the regulations and stated that:

> the effect of the final element ... , which reads "and other components relating to the operation or maintenance of a building," must be taken into account. That final element functions as a descriptive phrase intended to present the basic test used for identifying structural

> components. The preceding elements are examples of items which meet that test as a general rule. Items which occur in an unusual circumstance and do not relate to the operation or maintenance of a building should not be structural components despite being listed in section 1.48-1(e)(2), Income Tax Regs.

The Court of Claims takes a different view of these provisions. In Boddie-Noell Enterprises, Inc. v. U.S., 36 Cl. Ct. 722, 739 (1996), the court stated that:

> [b]ased on a reading of the clear language of the above statutory and regulatory scheme, to the extent any of the claimed items are expressly listed as a building or structural component in the regulations, they should be excluded from the definition of section 38 property and are not creditable.

The Claims Court, referring to Scott Paper Co. v. Commissioner, 74 T.C. 137 (1980), added that "[t]his court does not feel that a relaxed interpretation of the promulgated regulations is appropriate ... ." Boddie-Noell, 36 Cl. Ct. at 740.

In Hospital Corp. of America v. Commissioner, 109 T.C. 21 (1997) ("HCA"), the Tax Court concluded that tests developed under prior law for investment tax credit purposes could be used by taxpayers to distinguish section 1245 property from section 1250 property for depreciation purposes. In HCA the court considered whether various items in the taxpayer's buildings were structural components of the buildings or section 1245 property. In making this determination the court employed the factors set forth in Whiteco Indus., Inc. v. Commissioner, 65 T.C. 664, 672-673 (1975), to ascertain whether the items were inherently permanent and, accordingly, structural components. These factors are:

> (1) Is the property capable of being moved, and has it in fact been moved?
>
> (2) Is the property designed or constructed to remain permanently in place?
>
> (3) Are there circumstances, which tend to show the expected or intended length of affixation, i.e., are there circumstances, which show that the property may or will be moved?
>
> (4) How substantial a job is removal of the property and how time consuming is it; is it readily removable?
>
> (5) How much damage will the property sustain upon its removal?
>
> (6) What is the manner of affixation to the land?

Referring to its earlier decisions in Scott Paper and Morrison, the court in HCA also stated that an item constitutes a structural component of a building if the item relates to the operation and maintenance of the building. Property used to aid in the employment of a particular function or particular piece of property is not a structural component.

L.L. Bean, Inc. v. Commissioner, 73 TCM 2560 (1997), considered whether a storage facility, known as the "mezzanine system," located within the taxpayer's shipping building was section 38 property. The mezzanine system, part of the original construction plan when the shipping building was designed, did not support the ceiling or walls of the shipping building. Various other elements were connected to, or suspended from the underside of, the mezzanine system, including cable, electricity and communications, lighting fixtures, and sprinkler piping. The court found that the building was planned and designed with the integration of the mezzanine system in mind and concluded that the substantial time and effort involved in both the construction and potential removal of the system, as well as the degree of its integration with the building, reflected the permanent nature of the system. The court also concluded that these factors indicated that the mezzanine system was related to the operation and maintenance of the shipping building.

In L.L.Bean, the court also considered whether a particular facility could be considered an improvement to land because it was movable. The court stated that proper application of the Whiteco factors rests on the premise that movability itself is not the key determinant of lack of permanence, and the mere fact that the facility could theoretically be moved did not establish that it was not inherently permanent. See also HCA, 109 T.C. at 57. In finding that the facility was inherently permanent, the court noted that the facility was specifically designed for the site as an addition to taxpayer's distribution center and that the time and effort involved to move the facility would be substantial.

In the Action On Decision (AOD) in HCA, 1999-008 (August 30, 1999), the Service acquiesced in the court's decision to the extent that it held that the tests developed under prior law for investment tax credit purposes could be used by taxpayers to distinguish section 1245 property from section 1250 property for depreciation purposes. However, the Service did not agree with the conclusions reached by the court with respect to the various items of property at issue in the case. The reference in the AOD to Boddie-Noell and La Petite Academy, Inc. v. United States, 95-1 U.S.T.C. (CCH) 50,193 (W.D. Mo. 1995), cases in which items of property found by the HCA court to be section 1245 property were found to be section 1250 property, is an indication that the Service will carefully consider whether items of property specifically listed in the regulations as structural components are, because in the context of a particular case they appear in unusual circumstances and do not relate to the operation or maintenance of the building, section 1245 property.

The preceding discussion indicates that the determination of whether a particular item of property is a structural component of a building is highly factual. Of necessity the determination will involve an intense analysis of the facts and circumstances of the particular case. Unfortunately, no bright line test exists.

In the following discussion, we will apply the principles discussed above to the particular circumstances of the present case from the perspective of the national office. We will briefly consider each category of property at issue. The conclusions we reach regarding these categories are subject to change as warranted by continued factual development. As indicated above, items listed in the regulations are presumed to be structural components unless it can be shown that, because of unusual circumstances, they do not relate to the operation or maintenance of the building.

1. Exterior facades

Taxpayer states that in designing its hotel/casino complex its intention was to create a theme with which its patrons could identify. To this end, Taxpayer incorporated a specific decor into the property as a compliment to its overall theme of f extravagance.

The decorative exterior wall covering was placed on the entire exterior of Taxpayer's buildings to help create the theme for the hotel/casino complex. It consists of a synthetic plaster, or stucco, that is cemented, or in some cases, bolted on in the form of a panel, to the frames of the exterior walls of the buildings. The synthetic plaster is not readily moveable. In order to comply with local building codes, the facade was designed to withstand an 85 mph wind load. The facades provide a barrier to the outside elements and their removal would expose other building elements to degradation.

Section 1.48-1(e)(2) provides that the term "structural components" includes such parts of buildings as walls, as well as any permanent coverings therefor. Because there is no indication that Taxpayer's exterior facades are easily removable, under the general rule, they would fall within the scope of this provision unless it can be shown that, because of unusual circumstances, they do not relate to the operation or maintenance of the buildings.

An essential element of Taxpayer's overall theme, the exterior facades were part of Taxpayer's original plan of construction. To support this theme, the exterior facades were designed and constructed with the expectation they would remain in place indefinitely. Further, they were integrated with the buildings during their construction. Under Metro and L.L.Bean these factors are indicative of structural components.

The decorative nature of the exterior facades does not, by itself, mean that the facades occur in unusual circumstances and are not related to the operation or maintenance of the buildings, the exception to the general rule discussed in Scott Paper and HCA. Among the items considered by the Claims Court in Boddie-Noell were decorative mansard roof panels. Rejecting the taxpayer's argument, based upon Senate Report 95-1263, that the panels were analogous to false balconies and only incidentally related to the operation or maintenance of the building, the court found that the roof panels performed the essential function of keeping out the elements.

Decorative mansard roofs were also at issue in La Petite. Noting that the mansard roof was part of the initial construction of the buildings, the court found that the mansard roof was integrated into the overall roof system and was intended to remain permanently in place. The court observed that removal of the mansard roof would result in the direct exposure of various building components to water, snow, wind, and moisture damage. The court concluded that the roof had a more than incidental relationship to the operation or maintenance of the building.

Taxpayer's exterior facades are similar to the mansard roofs discussed in the preceding paragraph. Like the roofs, they perform the essential function of protecting other building components from the elements. The facades were designed to withstand severe weather conditions and their removal would expose the buildings to significant damage and would necessitate major reconstruction. Thus, their relation to the operation or maintenance of the buildings is more than incidental. Because it cannot be argued that the facades do not relate to the operation or maintenance of the buildings, the exception to the general rule found by the court in Scott Paper and HCA is not applicable to Taxpayer's facades and, thus, they constitute section 1250 property.

We note that even if the facades were moveable this fact would not be dispositive. In L.L.Bean the court noted that an element of a building so integrated with the structure of the building that it is unlikely to be moved will be considered to be a structural component.

2. Decorative ceilings

The ceilings consist of ornamental polished gold and copper metal panels suspended from the finished ceiling or glued to soffits or lowered drywall ceiling systems. The suspension grids are hung by hanger wires from hooks or eyes set in the floor above or bottom of the roof, and attached to walls with nails or screws. Components such as lighting fixtures and air conditioning registers are placed on the grid. The ceilings hide plumbing, wiring, sprinkler systems and air conditioning ducts. By serving as a channel for the return air, the ceilings also operate as a component of the heating and air conditioning system.

Section 1.48-1(e)(2) provides that the term "structural components" includes such parts of a building as ceilings, as well as any permanent coverings therefor. Taxpayer's decorative ceilings are capable of being moved, but movability itself is not the key determinant of lack of permanence. L.L.Bean. In HCA, the court concluded that suspended acoustical ceilings were structural components and stated that movability is only one factor to be considered in determining whether property is a structural component.

Many of our observations regarding Taxpayer's exterior facades are equally applicable to Taxpayer's decorative ceilings. Like the facades, the decorative ceilings were designed to enhance the overall theme of the hotel/casino complex and they were part of the original plan of construction. While removal of the ceilings would not place other elements of the building in jeopardy, it would require a major renovation of the interior of the building because the wiring, plumbing, and ventilation components located behind the ceilings would be exposed. Like the mezzanine system considered by the court in L.L.Bean, other building elements are connected to the ceilings. In addition, the ceilings complement the buildings' heating and air conditioning systems. Of course, removal of the ceilings would have an adverse effect on Taxpayer's overall theme. These factors suggest the likelihood of ceiling removal is very low. Accordingly, we conclude that Taxpayer's decorative ceilings are integrated into the overall design of the buildings sufficiently to be considered structural components of the buildings.

We note that suspended or "false" ceilings were found to be structural components by the courts in Metro, Boddie-Noell, and HCA.

3. Wall coverings

The wall coverings at issue are described as "strippable wall paper and vinyl wall coverings." The wall coverings are installed using strippable adhesive and can be removed easily for repair work and renovation projects. Such removal will not damage the walls.

Section 1.48-1(e)(2) provides that the term "structural components" includes such parts of buildings as walls, as well as any permanent coverings therefor. Application of the Whiteco factors to the wall coverings at issue does not support a structural component conclusion. Taxpayer's easily removable wall coverings are similar to the vinyl wall coverings considered by the court in HCA. In that case the court concluded that the vinyl wall coverings were not intended to be, and were not, a permanent covering for the hospital walls. The court contrasted the hospital's easily removable vinyl wall coverings with the tiles glued to the walls and floors of a fast food restaurant, which the court found to be structural components in Duaine v. Commissioner, T.C. Memo. 1985-39. The court's analysis in this context is consistent with the Service's focus on manner of attachment as discussed in Rev.

Rul. 67-349, 1967-2 C.B.48, which holds that carpeting put down on a floor with wooden carpet strips is not integral to the floor.

As noted by the court in Metro, the items listed in the regulations are generally installed with the expectation that they will remain in place indefinitely. The removal of Taxpayer's wall coverings would not require the degree of time and expense indicative of the structural integration discussed in L.L.Bean and Metro. Accordingly, we believe Taxpayer's wall coverings are not structural components and should be treated as section 1245 property.

We note that language in Senate Report 95-1263 indicates that adhesive attachment is recognized as non-permanent.

4. Millwork

"Millwork" refers to the decorative finish carpentry located throughout Taxpayer's hotel/casino complex. These items were manufactured at millwork plants and brought to the building site for installation. Examples of Taxpayer's millwork include detailed crown moldings for the ceilings, ornate wall paneling systems, and lattice work for walls and ceilings. Obviously, the buildings were designed with the finished carpentry in mind, and the millwork serves to enhance Taxpayer's overall theme for the hotel/casino complex.

Section 1.48-1(e)(2) provides that the term "structural components" includes such parts of a building as walls, partitions, floors, and ceilings, as well as any permanent coverings therefor such as paneling. The question presented is whether Taxpayer's millwork constitutes a permanent covering for these structural components. Based upon the material submitted, we are unable to determine if, under a Whiteco analysis, the millwork would be considered inherently permanent. However, the agent has indicated that the millwork is easily removable.

In our discussion of Taxpayer's decorative ceilings, we indicated that movability is only one factor to be considered in determining whether property is a structural component. However, unlike the ceilings in the present case, there is no indication that the millwork performs any building functions or provides a platform for other building elements. Thus, while removal of the millwork would effect the appearance of the buildings, it would not effect the buildings' operation in any material way. Accordingly, the millwork is not integrated into the design and construction of the buildings in the sense discussed by the courts in Metro and L.L.Bean.

The agent is correct in observing that particular items of millwork, such as doors and windows, are integral parts of finished building components. However, these items perform essential building functions while the millwork at issue appears to be

merely decorative and does not relate to the operation or maintenance of Taxpayer's buildings. See Senate Report 95-1263.

We note that in Morrison lattice millwork and decor window treatments were found to be tangible personal property. The court found that these items served merely decorative functions and could easily be removed at little cost without permanently damaging the underlying ceiling or walls. However, the court found that vanity cabinets and counters were structural components because they were permanently attached to the walls. The court found they could not be removed without damaging the underlying walls.

Based on the facts presented in the present case, we believe that Taxpayer's millwork should be treated as section 1245 property. Our consideration of Taxpayer's millwork assumes that, under Whiteco, it would not be considered to be permanently attached to other building elements. A different result would be obtained if the millwork is installed in such a way as to render it comparable to the cabinets and counters considered by the court in Morrison.

6. Lighting

Taxpayer's hotel/casino complex makes use of a variety of lighting fixtures. Basic illumination is provided by recessed ceiling lights. These lights are classified as structural components and are not at issue. Additional illumination is provided by a variety of decorative lighting fixtures, including chandeliers, wall sconces, track spot lighting, torch lighting, and wall wash fixtures. Again, these decorative lights serve to enhance Taxpayer's overall theme.

Section 1.48-1(e)(2) includes electric wiring and lighting fixtures as an example of structural components. However, under Scott Paper and HCA, these items must relate to the operation or maintenance of the building in order to be structural components.

Senate Report 95-1263 states that "special lighting" relates only incidentally to the operation or maintenance of a building and should be considered tangible personal property. In Metro the court concluded that decorative lighting was special lighting within the meaning of the Senate Report. In Morrison the court stated that lighting fixtures and electrical connections that do not provide basic illumination and are accessory to a business are not structural components. The court found the taxpayer's chandeliers and decor wall lights to be special lighting unrelated to the operation or maintenance of the building. In Duaine decorative lighting fixtures were found to be structural components because they provided the only lighting in the building.

In the present case, basic illumination is provided by recessed ceiling fixtures. Although admittedly on a much grander scale, we believe Taxpayer's decorative lighting is analogous to the circumstances addressed by the court in Morrison, and is special lighting only incidentally related to the buildings' operation or maintenance. Thus, we conclude that Taxpayer's decorative lighting at issue should be treated as section 1245 property.

7. Kitchen equipment hookups and guest room electrical outlets

The kitchen equipment hookups comprise the electrical distribution system of the kitchen. The distribution system is designed to provide the right amount of electrical current to each utilization point.

While section 1.48-1(e)(2) specifically includes electric wiring as an example of a structural component, under the case law the test is whether the particular item relates to the operation or maintenance of the building. In Scott Paper and Morrison the court stated that even though the regulations specifically mention such items as "wiring and lighting fixtures" in describing structural components, the item must relate to the operation or maintenance of the building in order to be classified as a structural component. Accordingly, the court focused on the ultimate uses of power at the buildings and distinguished the power used in the buildings' overall operation or maintenance, such as lighting, heating, ventilation, and air conditioning, from the power used to operate equipment and machinery. Components associated with equipment were considered tangible personal property. Similarly, in Duaine, the court concluded that electrical outlets and conduits providing localized power sources for specialized restaurant equipment constituted personal property.

We assume that the kitchen equipment hookups at issue in the present case are similar to the equipment considered by the court in Morrison and Duaine. We note that in Morrison the Service argued to no avail that the electrical kitchen components were of standard design rather than specially designed for the taxpayer's cafeterias. Accordingly, we conclude that Taxpayer's kitchen equipment hookups are not structural components and should be classified as section 1245 property.

The electrical outlets at issue are located in guest rooms and guest bathrooms. These outlets provide general access to electrical power and are not specifically associated with particular items of hotel equipment. Although some hotel equipment may be connected to these outlets, such as televisions, radios, and lighting fixtures, these items are easily disconnected and reconnected to other outlets. In HCA, the court classified electrical outlets in accordance with whose equipment (employee versus non-employee) could be connected to them. We share the agent's view that it is a simple matter to change the equipment at any wall

outlet, especially in a hotel room. We conclude that electrical outlets of general applicability and accessibility perform an essential building function and are structural components.

8. Emergency power generators

Taxpayer's emergency power system consists of two emergency standby generators with associated fuel tanks, feeder lines, alternator and controls, and battery powered lighting for critical operations. From the material submitted, we are uncertain as to the precise systems supported by Taxpayer's two emergency power generators. It is stated that one of the generators is sufficient to operate the "emergency/safety" features of Taxpayer's buildings, but that both generators are tied to the buildings' emergency/safety features. Apparently, excess capacity is utilized by Taxpayer's other hotel/casino equipment.

In HCA the court considered whether taxpayer's hospitals' primary and secondary electrical distribution systems were structural components. With its focus on the ultimate uses of power at the hospital buildings, the court followed its decisions in Scott Paper and Morrison, discussed above, and concluded that the portion of the cost of the primary and secondary electrical distribution systems in the taxpayer's hospitals that is equal to the percentage of the electrical load carried to those systems allocable to the hospitals' equipment is depreciable as section 1245 property.

In a Revised Action on Decision in Illinois Cereal Mills, Inc. Commissioner, T.C. Memo 1983-469, the Service agreed that it would no longer challenge the functional allocation approach set forth in Scott Paper regarding the classification of electrical systems as section 38 property.

While it is true, as the agent says, that in HCA the parties agreed before trial that the emergency generators at issue in that case were tangible personal property, the court did state that, in its view, the generators were assets accessory to the conduct of the taxpayer's business within the meaning of Senate Report 1881 and, consequently, did not relate to the operation or maintenance of the buildings. Similar reasoning had been applied by the court in Morrison, where the court concluded that the taxpayer's emergency lighting fixtures were not structural components but were assets accessory to the cafeteria business that enabled the taxpayer to accomplish its business objectives. Accordingly, we believe Taxpayer's emergency power generators should not be classified as structural components. However, if it can be determined that a percentage of Taxpayer's emergency power generators' output is attributable to building operations, a functional allocation along the lines of Scott Paper would be appropriate.

9. Door locks

Doors are specifically listed as structural components in section 1.48-1(e)(2). Under the case law, the listed items are structural components of a building as a general rule and will be considered as such unless they occur in unusual circumstances and do not relate to the operation and maintenance of the building. See Metro and HCA. Doors, especially in the context of a hotel building, are useless without a locking system. The locks are an integral part of the door. Further, the door locks are essential to the operation of the building as a hotel. We see no unusual circumstances surrounding Taxpayer's doors. Accordingly, the door locks, as an integral part of the doors, should be considered to be structural components of the building and should be classified as section 1250 property.

We note that the Tax Court applied both Scott Paper and Whiteco to interior doors in Morrision. The court stated that "doors constitute a structural component only if they are a permanent part of the cafeteria building, so that their removal would affect the essential structure of the building." However, the court also stated that the doors at issue did not function as an integral part of the taxpayer's cafeterias. As mentioned in the preceding paragraph, doors are essential to the operation of Taxpayer's building as a hotel. As such, they function as an integral part of Taxpayer's hotel.

Site Utilities

Taxpayer refers to the list of specific structural components in section 1.48-1(e)(2) in support of its contention that the site utilities at issue are land improvements rather than structural components. However, this section provides that structural components include, in addition to the specific items listed, "other components relating to the operation and maintenance of a building."

Rev. Rul. 70-160, 1970-1 C.B. 7, holds that an electrical distribution system transmitting energy from the power company to a building does not qualify as section 38 property because the system is a permanent building component servicing the overall electrical needs of the building and, as such, is a structural component relating generally to the overall operation of the building. The revenue ruling notes that the electrical distribution system is not directly associated with specific items of machinery or equipment.

The various site utilities at issue in the present case are analogous to the electrical distribution system addressed in Rev. Rul. 70-160. They distribute city furnished utility services to the building and are not directly associated with specific items of machinery and equipment. They will not be retired contemporaneously with the retirement of particular assets. Accordingly, the site utilities relate to the overall operation and maintenance of Taxpayer's building and are treated as structural components for depreciation purposes.

Outdoor Pylon Sign

The large outdoor pylon sign is used to draw attention to Taxpayer's hotel/casino complex and serves to enhance Taxpayer's f casino theme. The sign is not attached to a building. Taxpayer argues that the sign qualifies as personal property under the "sole justification test" of section 1.48-1(e)(2), and that the Whiteco factors are not applicable. We disagree with these contentions. The sole justification test is used to determine whether a particular item of property specifically listed in the regulations as an example of a structural component (for example, an air conditioning system) is, in the particular factual circumstances presented, a structural component of a building. Without considering whether Taxpayer's sign is the type of property to which the sole justification test is applicable, in the present case the issue presented is not whether the sign is a structural component of a building but whether the sign is an inherently permanent structure. Under section 1.48-1(c), tangible personal property does not include buildings or other inherently permanent structures. Accordingly, whether the sign is an inherently permanent structure is determined by application of the Whiteco factors.

We assume that under a Whiteco analysis the outdoor pylon sign would be determined to be an inherently permanent structure. Because this sign is not a building and asset class 79.0 does not include land improvements, Taxpayer's outdoor pylon sign is treated for depreciation purposes as a land improvement includible in asset class 00.3 of Rev. Proc. 87-56 and is depreciable over 15 years.

Rev. Rul. 69-170, 1969-1 C.B. 28, considered whether various items appurtenant to a sports stadium qualified as tangible personal property. Among the items considered were scoreboards and message boards mounted on large steel poles, attached to concrete foundations with steel bolts. The scoreboards and message boards were separate and apart from the stadium structure. The revenue ruling concluded that the score boards and message board were inherently permanent structures that housed equipment and circuitry. After noting that the equipment and circuitry can be replaced without having to replace the supporting and enclosing structure, the ruling held that the equipment and circuitry were tangible personal property but that the supporting and enclosing structures were inherently permanent structures.

Taxpayer's outdoor pylon sign is analogous to the score boards and message boards addressed in Rev. Rul. 69-170. If the sign houses electronic equipment, a portion of the sign should be treated as tangible personal property.

CASE DEVELOPMENT, HAZARDS AND OTHER CONSIDERATIONS:

As stated previously in our memorandum, the determination of whether a particular item of property is a structural component involves an intense factual analysis with few easy answers. Using the Whiteco factors as a general guideline regarding non-electrical components, [redacted]

In the present case, we have concluded that the exterior facades, decorative ceilings, guest room electrical outlets, and door locks of Taxpayer's hotel/casino complex are section 1250 property for depreciation purposes. We have also concluded that the outdoor sign at issue in the present case is a land improvement. [redacted]

As discussed below, we did not address the following additional items that were at issue in the present case.

1. Whirlpool hookups

This issue was not developed in the submission. We are inclined to agree with the agent's assessment that the hookups are part of an inherently permanent structure. If a Whiteco analysis supports this assessment, these hookups should be classified as section 1250 property.

2. Kitchen exhaust

This issue was not developed in the submission. In HCA, the court found that the kitchen exhaust system satisfied the sole justification test of the regulations. We note that in Morrison the court found that kitchen plumbing and the kitchen air makeup units were not structural components of taxpayer's buildings. [redacted]

3. Gazebos

It was unclear from the submission how these structures had been classified by Taxpayer. We assume the gazebos are inherently permanent under Whiteco. Because these structures are not part of a building, we agree with the agent's assessment that they are land improvements. Assuming the exterior facades supported by the gazebos have the same characteristics as the exterior facades discussed in our memorandum, we agree they should be depreciated in the same manner as the assets with which they are associated.

4. Interior facades

We were unable to establish from the material submitted the precise nature of this asset category. We assume the issue to be addressed is the classification of interior walls and storefronts, and their coverings, located inside Taxpayer's buildings. These serve to enhance Taxpayer's overall theme, of course. However, the agent states that Taxpayer did not treat the cost of the framework of the walls as personal property. In addition, we note that Taxpayer states that "millwork considered to be structural in appearance, such as storefronts and retail entryways and retail doors" was not treated as personal property. Unfortunately, we were uncertain what particular assets we were addressing here.

[redacted]

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.

If you have any questions regarding this Field Service Advice, please call (202) 622-3110.

Kathleen Reed