

26 CFR 601.204: Changes in accounting periods and in methods of accounting.

(Also Part I, §§ 446, 481; 1.446-1, 1.481-1.)

Rev. Proc. 2002-65

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SECTION 1. PURPOSE

This revenue procedure provides a safe harbor method of accounting for track structure expenditures paid or incurred by a Class II or Class III railroad (“track main-

tenance allowance method”). This revenue procedure also provides procedures for a qualifying taxpayer to obtain automatic consent from the Commissioner of Internal Revenue to change to the track maintenance allowance method, including rules relating to the limitations, terms, and conditions the Commissioner deems necessary to make the change. In addition, this revenue procedure provides an optional procedure for a qualifying taxpayer whose treatment of track structure expenditures is an issue under consideration in examination, before an area appeals office, or before the United States Tax Court (“Tax Court”) to settle open taxable years using the track maintenance allowance method.

SECTION 2. BACKGROUND

.01 Under § 446(b) of the Internal Revenue Code, the Commissioner has broad authority to determine whether a method of accounting clearly reflects income. If a taxpayer’s method of accounting does not clearly reflect income, the computation of taxable income must be made under a method that, in the opinion of the Secretary, does clearly reflect income. *See Thor Power Tool Co. v. Commissioner*, 439 U.S. 522 (1979); *Commissioner v. Hansen*, 360 U.S. 446 (1959); § 1.446-1(c)(2)(ii) of the Income Tax Regulations.

.02 Section 446(e) and § 1.446-1(e) provide that, except as otherwise provided, a taxpayer must secure the consent of the Commissioner before changing a method of accounting for federal income tax purposes. Section 1.446-1(e)(3)(ii) authorizes the Commissioner to prescribe administrative procedures setting forth the limitations, terms, and conditions deemed necessary to permit a taxpayer to obtain consent to change a method of accounting.

.03 Rev. Proc. 2002-18, 2002-13 I.R.B. 678, provides the procedures under § 446(b) and § 1.446-1(b) for changes in method of accounting imposed by the Internal Revenue Service. Rev. Proc. 2002-18 also provides the procedures that the Service will use for accounting method issues resolved by the Service on a nonaccounting-method-change basis.

.04 A railroad incurs track structure expenditures as a result of performing various activities to acquire, construct, maintain, repair, and improve track structure. To minimize disputes regarding the accounting for

these track structure expenditures, the Service will permit a railroad that complies with the requirements of this revenue procedure to account for track structure expenditures using the track maintenance allowance method described in section 5 of this revenue procedure.

SECTION 3. SCOPE

This revenue procedure applies to a taxpayer that chooses to account for track structure expenditures under the method described in section 5 of this revenue procedure, and that meets the following requirements: 1) the taxpayer is a Class II or Class III railroad as designated by the Surface Transportation Board, in accordance with 49 C.F.R. Part 1201 1-1; and 2) the taxpayer does not file, and is not a member of a combined reporting group that files, a Railroad Annual Report R-1 (“Form R-1”) with the Surface Transportation Board.

SECTION 4. DEFINITIONS

The following definitions apply solely for purposes of this revenue procedure:

.01 *Track Structure*. “Track structure” means the combination of a taxpayer’s rail and other track material (OTM), ties, and ballast, which provides a track for rail cars and equipment powered by locomotives.

.02 *Track Structure Expenditures*. “Track structure expenditures” for a particular taxable year are the sum of the taxpayer’s expenditures for that year for current additions (including new track structure), operating items, and removal costs.

.03 *Current Additions*. “Current additions” are the amounts included in track structure expenditures that represent capital additions to the taxpayer’s track structure for financial reporting purposes and that are taken into account for federal income tax purposes (*see, e.g.*, §§ 404 and 461). Thus, for example, current additions do not include the assigned value of relay materials.

.04 *New Track Structure*. “New track structure” means the amounts included in track structure expenditures that reflect the taxpayer’s expenditures for (1) track structure laid where none previously existed; (2) existing track structure acquired by the taxpayer; or (3) track structure previously abandoned by the taxpayer that must be rehabilitated or improved to make it suit-

able for the use intended by the taxpayer, that are taken into account for federal income tax purposes. New track structure includes the cost of acquiring and installing new track structure as well as the cost of any rehabilitation or improvement necessary to put newly acquired or previously abandoned track structure into operation. New track structure does not include any removal costs.

.05 *Assigned Value of Relay Materials.* The “assigned value of relay materials” means the amounts that reflect the taxpayer’s fair market value adjustments (excluding rewelding and other processing costs) for track materials relaid that were previously retired for financial reporting purposes. The assigned value of relay materials does not include relay track materials purchased by the taxpayer.

.06 *Operating Items.* “Operating items” are the amounts included in track structure expenditures that represent expenditures for track structure that are deducted for financial reporting purposes and that are taken into account for federal income tax purposes. Thus, for example, operating items do not include salvage material credits or the assigned value of relay materials.

.07 *Salvage Material Credits.* “Salvage material credits” means the amounts that reflect credits for the value of salvaged materials.

.08 *Removal Costs.* “Removal costs” means the amount included in track structure expenditures that represents the taxpayer’s expenditures for track removal for financial reporting purposes not already included in current additions or operating items and that are taken into account for federal income tax purposes.

SECTION 5. TRACK MAINTENANCE ALLOWANCE METHOD FOR CLASS II AND III RAILROADS

.01 *In General.* Under the track maintenance allowance method, the taxpayer must determine the amount of its track structure expenditures that may be currently deducted under section 5.02 of this revenue procedure (the track maintenance allowance) and the amount required to be capitalized under section 5.03 of this revenue procedure (the capitalized amount). A taxpayer that uses the track maintenance allowance method described in this section 5 must use that method for all of its track structure expenditures.

.02 *Track Maintenance Allowance.* The track maintenance allowance for a particular taxable year under the track maintenance allowance method is determined as follows:

- (1) Determine the track structure expenditures for the taxable year;
- (2) Subtract from the track structure expenditures in (1) new track structure; and
- (3) Multiply the resulting amount in (2) by 75 percent.

.03 *Capitalized Amount.* The capitalized amount for the taxable year under the track maintenance allowance method is determined as follows:

- (1) Determine the track structure expenditures for the taxable year (see section 5.02(1));
- (2) Subtract from the track structure expenditures in (1) the track maintenance allowance determined under section 5.02 for the taxable year to determine the capital track structure expenditures;
- (3) Allocate the capital track structure expenditures determined in (2) to each track account (Rail and OTM, Ties, and Ballast) first to new track to the extent of the new track structure for each track account. The remaining capitalized amount

represents replacement track and should be allocated to each track account in proportion to adjusted current additions (*i.e.*, current additions for each track account after excluding the amount allocated to new track from each account). If after allocating the capital track structure expenditures to new track there are no adjusted current additions, the remaining capitalized amount must be allocated to each track account in proportion to the ending book account balance in each track capital account for the taxable year. For purposes of determining basis, the amounts allocated to each track account must be allocated further to the assets within each account using any reasonable method;

(4) For each track account, apply the taxpayer’s method of accounting for uniform capitalization, as governed by § 263A and the regulations thereunder, to the amounts capitalized to new track and to replacement track (*i.e.*, the amounts determined in (3)) to determine the additional § 263A costs (as defined in § 1.263A-1(d)(3)), and, if applicable, interest costs, that must be capitalized;

(5) For each track account, add the amounts capitalized to new track and to replacement track in (3) to the § 263A costs and interest costs determined in (4) to determine the total capitalized amount;

(6) For each track account, treat the total capitalized amount determined in (5) as a capital expenditure and depreciate that amount in accordance with § 167 and the regulations thereunder.

.04 *Example.*

(1) *Facts.* X is a railroad that owns and maintains track structure in the United States. X uses a calendar year for tax purposes. For the year ending December 31, 2001, X treats the following amounts as capital additions to its track structure for financial reporting purposes:

Ties	\$1,180,000
Rail & OTM	370,000
Ballast	<u>600,000</u>
Total	\$2,150,000

Included in this amount are:

New track structure	Ties	\$150,000
	Rail & OTM	\$250,000
	Ballast	<u>\$100,000</u>
	Total	\$500,000
Assigned value of relay materials	Ties	\$ 30,000
	Rail & OTM	\$120,000
	Ballast	<u>\$ 0</u>
	Total	\$150,000

All of these amounts are taken into account for federal income tax purposes in the taxable year ended December 31, 2001, except for the assigned value of relay materials. Thus, X's current additions for the taxable year ending December 31, 2001, are \$2,000,000 (\$2,150,000 – \$150,000).

For the same taxable year, X has expenditures for its track structure that are deducted for financial reporting purposes in the amount of \$2,250,000.

Included in this amount are:

Salvage material credits	(\$50,000)
Assigned value of relay materials	\$100,000

All of X's expenditures for track structure that are deducted for financial reporting purposes are taken into account for federal income tax purposes in the taxable year ended December 31, 2001, except for the salvage material credits and the assigned value of relay materials. Thus, X's operating items for the taxable year ended December 31, 2001, are \$2,200,000 (\$2,250,000 + \$50,000 – \$100,000). For the taxable year ended December 31, 2001, X incurred removal costs in the amount of \$300,000, which were not included in current additions or operating items, but which are taken into account for federal income tax purposes in that year.

(2) *Track maintenance allowance.* To determine the track maintenance allowance for the taxable year ended December 31, 2001, X first determines its track structure expenditures, as follows:

\$2,000,000	current additions
2,200,000	operating items
<u>+300,000</u>	removal costs
\$4,500,000	track structure expenditures

X then adjusts its track structure expenditures as follows:

\$4,500,000	track structure expenditures
<u>(500,000)</u>	new track structure
\$4,000,000	adjusted track structure expenditures

X then determines the track maintenance allowance as follows:

\$4,000,000	adjusted track structure expenditures
x .75	allowance
<u>\$3,000,000</u>	track maintenance allowance

(3) *Capitalized amount.* To determine the capitalized amount, X first determines the capital track structure expenditures by subtracting the track maintenance allowance determined in (2) as follows:

\$4,500,000	track structure expenditures
-------------	------------------------------

(3,000,000) track maintenance allowance
 \$ 1,500,000 capital track structure expenditures

X then allocates its capital track structure expenditures to each track account (Rail and OTM, Ties, and Ballast) first to new track to the extent of the \$500,000 of new track structure for each track account. The remaining \$1,000,000 of capital track structure expenditures is then allocated to replacement track for each track account in proportion to the adjusted current additions. Thus, X allocates these amounts as follows:

	Current Additions	Amount Capitalized— New Track	Adjusted Current Additions	Amount Capitalized— Replacement Track
Ties	\$1,150,000	\$150,000	\$1,000,000	\$ 666,667
Rail & OTM	\$ 250,000	250,000	0	0
Ballast	600,000	100,000	500,000	333,333
Total	\$2,000,000	\$500,000	\$1,500,000	\$1,000,000

For each track account, X applies its method of accounting for uniform capitalization under § 263A to the amounts capitalized to new track and to replacement track to determine the additional § 263A costs that must be capitalized. The total capitalized amount for each track account is determined by combining the amounts capitalized to new track and to replacement track with the § 263A costs for each track account. X must depreciate the total capitalized amount for each track account in accordance with § 167 and the regulations thereunder.

SECTION 6. CHANGE IN METHOD OF ACCOUNTING

.01 *In General.* A change in a taxpayer's treatment of track structure expenditures to the track maintenance allowance method is a change in method of accounting to which §§ 446 and 481 apply.

.02 *Issue Not Under Consideration.* If a taxpayer within the scope of this revenue procedure wants to change to the track maintenance allowance method for either its first or second taxable year ending on or after December 31, 2001, ("year of change") and the treatment of its track structure expenditures is not an issue under consideration in examination, before an area appeals office, or before a federal court (within the meaning of section 3.09 of Rev. Proc. 2002-9, 2002-3 I.R.B. 327) on September 30, 2002, the taxpayer must follow the automatic change in method of accounting provisions in Rev. Proc. 2002-9 (or its successor) with the following modifications:

(1) The scope limitations in section 4.02 of Rev. Proc. 2002-9 do not apply.

(2) A taxpayer that wants to change to the track maintenance allowance method for its first taxable year ending on or after December 31, 2001, and that, on or before November 29, 2002, files its original federal income tax return for its first taxable year ending on or after December 31, 2001, is not subject to the filing requirements in section 6.02(3)(a) of Rev. Proc. 2002-9, provided that it complies with the following filing requirements. The taxpayer must complete and file a Form 3115 in duplicate. The original must be attached to the taxpayer's amended federal income tax return for its first taxable year ending on or after December 31, 2001. This amended return must be filed no later than June 30, 2003. A copy of the Form 3115 must be filed with the national office (see section 6.02(6)(a) of Rev. Proc. 2002-9 for the address) no later than when the taxpayer's amended return is filed.

(3) To assist the Service in processing changes in method of accounting under this section of the revenue procedure, and to ensure proper handling, section 6.02(4) of Rev. Proc. 2002-9 is modified to require that a Form 3115 filed under this revenue procedure include the statement: "Automatic Change Filed Under Rev. Proc. 2002-65." This statement should be legibly printed or typed at the top of any Form 3115 filed under this revenue procedure.

.03 *Issue Under Consideration.* If a taxpayer within the scope of this revenue procedure wants to change to the track maintenance allowance method for either

its first or second taxable year ending on or after December 31, 2001, ("year of change") and the treatment of its track structure expenditures is an issue under consideration in examination, before an area appeals office, or before a federal court (within the meaning of section 3.09 of Rev. Proc. 2002-9) on September 30, 2002, the taxpayer must follow the automatic change in method of accounting provisions in Rev. Proc. 2002-9 with the following modifications:

(1) The scope limitations in section 4.02 of Rev. Proc. 2002-9 do not apply.

(2) A taxpayer that wants to change to the track maintenance allowance method for its first taxable year ending on or after December 31, 2001, and that, on or before November 29, 2002, files its original federal income tax return for its first taxable year ending on or after December 31, 2001, is not subject to the filing requirements in section 6.02(3)(a) of Rev. Proc. 2002-9, provided that it complies with the following filing requirements. The taxpayer must complete and file a Form 3115 in duplicate. The original must be attached to the taxpayer's amended federal income tax return for its first taxable year ending on or after December 31, 2001. This amended return must be filed no later than June 30, 2003. A copy of the Form 3115 must be filed with the national office (see section 6.02(6)(a) of Rev. Proc. 2002-9 for the address) no later than when the taxpayer's amended return is filed.

(3) To assist the Service in processing changes in method of accounting under this section of the revenue procedure,

and to ensure proper handling, section 6.02(4) of Rev. Proc. 2002–9 is modified to require that a Form 3115 filed under this revenue procedure include the statement: “Automatic Change Filed Under Rev. Proc. 2002–65.” This statement should be legibly printed or typed at the top of any Form 3115 filed under this revenue procedure.

(4) The change to the track maintenance allowance method will be made using a “cut-off method.” Under a cut-off method, only the items arising on or after the beginning of the year of change are accounted for under the track maintenance allowance method. Any items arising before the year of change continue to be accounted for under the taxpayer’s former method of accounting, unless such method of accounting is changed as a result of an examination or a return filed for a year before the year of change. Because no items are duplicated or omitted from income when a cut-off method is used to effect a change in accounting method, no § 481(a) adjustment is necessary.

(5) Section 7 of Rev. Proc. 2002–9 does not apply. The taxpayer does not receive audit protection in connection with a change to the track maintenance allowance method.

.04 *Special Rule for Certain Taxpayers with Issue Under Consideration.* If a taxpayer is within the scope of this revenue procedure, and the treatment of its track structure expenditures is an issue under consideration (within the meaning of section 3.09 of Rev. Proc. 2002–9) in examination, before an area appeals office, or before the Tax Court on September 30, 2002, the taxpayer may change to the track maintenance allowance method for its first or second taxable year ending on or after December 31, 2001, under section 6.03 of this revenue procedure or, alternatively, for an earlier taxable year under section 8 of this revenue procedure.

.05 *Special Rule for Taxpayers Reclassified as Class I Railroads.* In the event that a Class II or Class III railroad is reclassified as a Class I railroad by the Surface Transportation Board and required to file a Form R–1, the railroad is not eligible to use the method under this revenue procedure for any taxable year that it is a Class

I railroad and must change its method of accounting for track structure expenditures, beginning with its first full taxable year as a Class I railroad. The reclassified railroad may adopt the safe harbor method of accounting for track structure expenditures of Rev. Proc. 2001–46, 2001–2 C.B. 263, if it otherwise qualifies, and must do so on a cut-off basis. To this extent, section 6.06 of Rev. Proc. 2001–46 is amplified.

.06 *Changes Not Made under this Revenue Procedure.* A taxpayer that wants to change to the track maintenance allowance method described in section 5 of this revenue procedure that does not change its method of accounting under section 6 or 8 of this revenue procedure must follow the change in method of accounting provisions in Rev. Proc. 97–27, 1997–1 C.B. 680 (or any successor).

SECTION 7. RECORD KEEPING

Section 6001 provides that every person liable for any tax imposed by the Code, or for the collection thereof, must keep such records, render such statements, make such returns, and comply with such rules and regulations as the Secretary may from time to time prescribe. The books or records required by § 6001 must be kept at all times available for inspection by authorized internal revenue officers or employees, and must be retained so long as the contents thereof may become material in the administration of any internal revenue law. Section 1.6001–1(e). In order to satisfy the record keeping requirements of § 6001 and the regulations thereunder, a taxpayer that changes to the track maintenance allowance method should maintain records substantiating all aspects of entitlement to the deduction, including, but not limited to, the following:

.01 Work papers or reports that identify and extract the taxpayer’s costs for current additions, operating items, and new track structure, including costs to rehabilitate or improve newly acquired or previously abandoned track structure;

.02 Work papers or reports that identify and extract the taxpayer’s assigned value of relay materials and salvage material credits; and

.03 Work papers or reports that identify the amount of removal costs.

SECTION 8. OPTIONAL SETTLEMENT FOR TAXPAYERS UNDER EXAMINATION, BEFORE AN AREA APPEALS OFFICE, OR BEFORE THE TAX COURT

.01 *In General.* If a taxpayer is within the scope of this revenue procedure; the treatment of its track structure expenditures is an issue under consideration (within the meaning of section 3.09 of Rev. Proc. 2002–9) in examination, before an area appeals office, or before the Tax Court on September 30, 2002; and the taxpayer does not change to the track maintenance allowance method under section 6.03 of this revenue procedure, the Service offers to settle the track structure expenditure issue by changing the taxpayer’s method of accounting for track structure expenditures to the track maintenance allowance method in the earliest open taxable year after which there is no closed taxable year.

.02 *Terms of Settlement.*

(1) The Service will change the taxpayer’s method of accounting for track structure expenditures to the track maintenance allowance method described in section 5 of this revenue procedure.

(2) The change to the track maintenance allowance method will be made in the earliest open taxable year after which there is no closed taxable year using a cut-off method.

(3) The taxpayer must reflect the settlement on its federal income tax returns for any affected succeeding taxable years. For example, an amount required to be capitalized during a taxable year covered by the settlement should be depreciated in that taxable year and in affected succeeding taxable years (whether or not covered by the settlement) in accordance with the taxpayer’s method of accounting for depreciation.

(4) The Service will not require the taxpayer to change its method of accounting for track structure expenditures to a method other than the track maintenance allowance method for any taxable year for which a federal income tax return has been

filed as of the date of the closing agreement or other appropriate settlement agreement, provided that:

(a) the taxpayer has complied with all the applicable provisions of the closing agreement or other appropriate settlement agreement;

(b) there has been no taxpayer fraud, malfeasance, or misrepresentation of a material fact;

(c) there has been no change in the material facts on which the closing agreement or other appropriate settlement agreement was based; and

(d) there has been no change in the applicable law on which the closing agreement or other appropriate settlement agreement was based.

(5) The taxpayer must execute a closing agreement under § 7121 or other appropriate settlement agreement as described in section 8.05 of this revenue procedure.

.03 Procedures for Requesting the Settlement.

(1) Initiating the request.

(a) *Taxable years under examination or in Appeals.* A taxpayer that wants to request a settlement under this section for taxable years under examination or in Appeals must submit its request in writing to the first line examination manager or appeals officer (whichever is applicable) on or before June 30, 2003.

(b) *Taxable years before the Tax Court.* A taxpayer that wants to request a settlement under this section for taxable years before the Tax Court must submit its request in writing to the Chief Counsel attorney assigned to the case on or before the earlier of June 30, 2003, or the date that is 30 days before the date the case is first set for trial, which is the date scheduled for the calendar call.

(2) *Statement of facts, law, and arguments.* The request for settlement must include the following information:

(a) the taxpayer's name, address, telephone number, and taxpayer identification number;

(b) the taxable years covered by the proposed settlement;

(c) the taxpayer's earliest open taxable year after which there is no closed taxable year;

(d) the taxpayer's current method of accounting for track structure expenditures;

(e) a statement of the material facts, including the track maintenance allowance and the capitalized amount under the track maintenance allowance method for each taxable year under examination, before an area appeals office, or before the Tax Court, and an explanation of the computations used to determine those amounts; and

(f) a statement of whether the track maintenance allowance for each taxable year under examination, before an area appeals office, or before the Tax Court is taken into account for federal income tax purposes, for example, whether the amount was incurred under § 461 in that taxable year, and, if § 404 applies to any portion of the amount in a particular taxable year, whether that portion meets the deductibility requirements of § 404.

(3) *Perjury statement.* The request for settlement must be accompanied by the following declaration: "Under penalties of perjury, I declare that I have examined this request, including accompanying documents, and, to the best of my knowledge and belief, the request contains all the relevant facts relating to the request, and such facts are true, correct, and complete." This declaration must be signed by, or on behalf of, the taxpayer by an individual with the authority to bind the taxpayer in these matters. The declaration may not be signed by the taxpayer's representative.

.04 Procedures for Processing the Request.

(1) *Receipt of request acknowledged.* The first line examination manager, appeals officer, or Chief Counsel attorney (whichever is applicable) will acknowledge receipt of the taxpayer's request for settlement in writing within 15 business days of receipt.

(2) *Factual development.* The first line examination manager, appeals officer, or Chief Counsel attorney (whichever is applicable) will contact the taxpayer to discuss any questions the Service may have, or ask for additional information believed to be necessary to execute the settlement (for example, to verify the correctness of the taxpayer's information).

(3) *Acceptance.* The first line examination manager, appeals officer, or Chief Counsel attorney (whichever is applicable) will accept the taxpayer's request for settlement if the request complies with the applicable terms of this revenue procedure. For

taxable years before the Tax Court, the settlement is subject to the approval of the Court.

(4) *Notification of acceptance.* The first line examination manager, appeals officer, or Chief Counsel attorney (whichever is applicable) will notify the taxpayer in writing when the Service agrees to the settlement requested by the taxpayer.

.05 Procedures for Implementing the Settlement.

(1) *Closing agreement or other appropriate settlement agreement required.* A taxpayer implementing a settlement is required to execute a closing agreement under § 7121 or other appropriate settlement agreement.

(2) *Contents of closing agreement or other appropriate settlement agreement.* A closing agreement or other appropriate settlement agreement must comply with the requirements of Rev. Proc. 68-16, 1968-1 C.B. 770, and, in the case of a closing agreement, must be substantially in the form set forth in the APPENDIX of this revenue procedure. Settlement agreements in cases pending before the Tax Court must conform substantially to the provisions set forth in the APPENDIX of this revenue procedure and must conform to the rules and procedures of the Tax Court.

(3) *Review and execution of closing agreement or other appropriate settlement agreement.*

(a) *Taxpayers under examination.* The first line examination manager will prepare a closing agreement. The first line examination manager should submit the closing agreement to the Ground Transportation Technical Advisor and his assigned counsel for review prior to submitting the closing agreement to the taxpayer for execution. Failure to submit the closing agreement to the Technical Advisor or his assigned counsel for review will not invalidate the closing agreement. After the closing agreement has been executed by the taxpayer, it will be executed on behalf of the Service by the Director, Field Operations (LMSB) MCT, New Jersey.

(b) *Taxpayers before an area appeals office.* The appeals officer or appeals team case leader will prepare a closing agreement. After the closing agreement has been executed by the taxpayer, it will be executed on behalf of the Service by an authorized official from Appeals.

(c) *Taxpayers before the Tax Court.* For docketed tax years before the Tax Court, the taxpayer and the Chief Counsel attorney must prepare an appropriate settlement document, settlement stipulation, or stipulated decision document, pursuant to the rules and procedures of the court. Such settlement document, settlement stipulation, or stipulated decision document is subject to the approval of the court.

(4) *Amended returns.*

(a) *In general.* In cases pending before examination or appeals, the Service will make the adjustments necessary to reflect the settlement to the taxpayer's returns for the taxable years under examination or before an area appeals office. In cases pending before the Tax Court, the settlement agreement will include adjustments necessary to reflect the settlement with respect to the year(s) before the court. The taxpayer is required to file amended returns to reflect the settlement for any other affected taxable years for which a federal income tax return has been filed as of the date of the closing agreement. The amended returns must include the adjustments to taxable income necessary to reflect the new method and any collateral adjustments to taxable income or tax liability resulting from the change. A taxpayer eligible to file a "qualified amended return" under Rev. Proc. 94-69, 1994-2 C.B. 804, may satisfy the requirements of this section by filing a qualified amended return in accordance with that revenue procedure.

(b) *Time and manner.* The taxpayer must file any required amended returns on or before the date it executes the closing agreement or other appropriate settlement agreement. The taxpayer must provide a copy of the amended returns to the first line examination manager, appeals officer, or Chief Counsel attorney (whichever is applicable) at the time it files the amended returns.

(5) *Application of Rev. Proc. 2002-18.* Except as otherwise provided in this revenue procedure, the provisions of Rev. Proc. 2002-18 will apply to any settlement under section 8 of this revenue procedure.

.06 *Effect on Other Offices of the Service.* If a taxpayer is before an area appeals office or the Tax Court regarding the treatment of its track structure expenditures and does not settle this issue under the

provisions of this section 8, an appropriate representative from an area appeals office or Chief Counsel office may settle a particular taxpayer's case involving this issue on a more favorable or less favorable basis than provided in this revenue procedure. For example, an appeals officer may settle a case based on the hazards of litigation.

SECTION 9. EFFECTIVE DATE

This revenue procedure is effective for taxable years ending on or after December 31, 2001.

SECTION 10. EFFECT ON OTHER DOCUMENTS

Rev. Proc. 2002-9 is modified and amplified to include this accounting method change in the APPENDIX. Rev. Proc. 2001-46 is amplified to address the reclassification of a Class II or III railroad to a Class I railroad.

DRAFTING INFORMATION

The principal author of this revenue procedure is Patricia Zweibel of the Office of Associate Chief Counsel (Income Tax and Accounting). For further information regarding this revenue procedure, contact Ms. Zweibel at (202) 622-5020 (not a toll-free call).

APPENDIX

Department of the Treasury Internal Revenue Service

Closing Agreement on Final Determination Covering Specific Matters

Under § 7121 of the Internal Revenue Code of 1986, [Taxpayer's name, address, telephone number, and identifying number] ("the taxpayer") and the Commissioner of Internal Revenue make the following closing agreement:

WHEREAS:

1. The taxpayer is a Class II or Class III railroad, as designated by the Surface Transportation Board, that is not required to file a Form R-1.

2. The issue covered in this closing agreement is the taxpayer's treatment of track structure expenditures incurred as a result of performing various activities to acquire, construct, maintain, repair, and improve track structure. The definition of "track structure expenditures" and other

terms defined in section 4 of Rev. Proc. 2002-65, apply for purposes of this closing agreement.

3. The taxable years covered by this closing agreement are [insert applicable taxable years].

4. The taxpayer currently accounts for track structure expenditures as follows: [insert taxpayer's current method of accounting for track structure expenditures].

5. The taxpayer and the Internal Revenue Service ("Service") rely on the following facts and representations in making this closing agreement: [insert relevant facts, including the track maintenance allowance and the capitalized amount under the track maintenance allowance method for each taxable year under examination, before an area appeals office, or before the Tax Court, an explanation of the computations used to determine those amounts, and a statement of whether the track maintenance allowance for each of those taxable years is taken into account for federal income tax purposes].

NOW IT IS HEREBY DETERMINED AND AGREED for federal income tax purposes:

1. That the Service is changing the taxpayer's method of accounting for track structure expenditures to the track maintenance allowance method of accounting described in section 5 of Rev. Proc. 2002-65, for the taxable year ending [insert earliest open taxable year after which there is no closed taxable year].

2. That the method change will be implemented using a cut-off method.

3. That the adjustments to taxable income necessary to reflect the new method, and any collateral adjustments to taxable income or tax liability resulting from the change for each of the taxable years covered by this agreement, are as follows: [insert appropriate adjustments].

4. (If appropriate), That the taxpayer has filed any amended returns required by section 8.05(4) of Rev. Proc. 2002-65, to reflect the settlement.

5. That the Service will not require the taxpayer to change its method of accounting for track structure expenditures to a method other than the track maintenance allowance method for any taxable year for which a federal income tax return has been filed as of the date of this closing agreement, provided that: (a) the taxpayer has complied with all the applicable provi-

sions of the closing agreement; (b) there has been no taxpayer fraud, malfeasance, or misrepresentation of a material fact; (c) there has been no change in the material facts on which the closing agreement was based; and (d) there has been no change in the applicable law on which the closing agreement was based.

6. That the Service is not precluded from challenging the computation of the track maintenance allowance for any taxable year covered by this closing agreement on a basis unrelated to the track maintenance allowance method (for example, that all or

a portion of the amount is not incurred under § 461 or that the taxpayer has not properly applied the uniform capitalization rules of § 263A and the regulations thereunder).

7. That the taxpayer accepts this settlement and agrees to the applicable terms of Rev. Proc. 2002-65.

This agreement is final and conclusive except:

(1) The matter it relates to may be reopened in the event of fraud, malfeasance, or misrepresentation of a material fact;

(2) It is subject to the Internal Revenue Code sections that expressly provide that effect be given to their provisions (including any stated exception for § 7122) notwithstanding any law or rule of law; and

(3) If it relates to a tax period ending after the date of this agreement, it is subject to any law enacted after the agreement date, that applies to the tax period.

By signing, the parties certify that they have read and agreed to the terms of this document.

Taxpayer (other than individual):

By: _____

Date: _____

Title: _____

Commissioner of Internal Revenue:

By: _____

Date: _____

Title: _____

Instructions

[This agreement must be signed and filed in triplicate. (All copies must have original signatures.) The original and copies of the agreement must be identical. The name of the taxpayer must be stated accurately. The agreement may relate to one or more years.

If an attorney or agent signs the agreement for the taxpayer, the power of attorney (or a copy) authorizing that person to sign must be attached to the agreement.

If the taxpayer is a corporation, the agreement must be dated and signed with the name of the corporation, the signature and title of an authorized officer or officers, or the signature of an authorized attorney or agent. It is not necessary that a copy of an enabling corporate resolution be attached.

Use additional pages if necessary and identify them as part of this agreement.

Please see Rev. Proc. 68-16, 1968-1 C.B. 770, for a detailed description of practices and procedures applicable to most closing agreements.]

I have examined the specific matters involved and recommend the acceptance of the proposed agreement

(Receiving Officer) _____

(Date) _____

(Title) _____

I have examined the specific matters involved and recommend the acceptance of the proposed agreement

(Receiving Officer) _____

(Date) _____

(Title) _____