



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

LARGE AND MID-SIZE
BUSINESS DIVISION

March 7, 2003

MEMORANDUM FOR INDUSTRY DIRECTORS, LMSB
DIRECTOR, FIELD SPECIALISTS, LMSB
DIRECTOR, PREFILING AND TECHNICAL GUIDANCE, LMSB
DIVISION COUNSEL, LMSB
DIRECTOR, COMPLIANCE, SBSE

FROM: Thomas W. Wilson, Jr. /s/ Thomas W. Wilson, Jr.
Industry Director, Communications, Technology & Media

SUBJECT: Audit Procedures to Determine Recovery Period of
Various Components of a Casino/Hotel Complex

INTRODUCTION

On March 7, 2003 the Industry Director, Communications, Technology & Media, issued a memorandum containing recommendations for the categories and lives of various assets when examining a taxpayer who is recovering construction costs through depreciation of tangible property used in connection with a hotel/casino complex. If a taxpayer categorizes specific assets differently than discussed in the memorandum, adjustments may be appropriate. The following items should be considered during the examination of depreciation for a land-based hotel/casino complex. Special rules may apply to floating casinos.

1. Determine the recovery period being used by the taxpayer for each category of asset.
 - A. Facades (Decorative exterior wall covering of the hotel/casino complex)
 - B. Ceilings (Dropped or lowered ceilings with decorative finishes)
 - C. Wall coverings (Strippable wall paper and vinyl)
 - D. Millwork (Includes molding, trim, paneling, and finish carpentry)
 - E. Lighting (Chandeliers, wall sconces, down lighting, neon lighting, column lights, theater lighting plus cost of the wiring and electrical connections associated with these fixtures)
 - F. Kitchen equipment hookups and guest room electrical outlets
 - G. Generators (Emergency power generators for emergency/safety systems and casino operations)
 - H. Door locks (Hotel guest room computerized door locks)
 - I.

- J. Site utilities (systems that are used to distribute city-furnished utility services, including water, sewer, gas and electricity, from the property line to the hotel/casino complex)
- K. Outdoor pylon sign (Consists of a superstructure and a television-like message screen)

If the taxpayer's categorization of these assets differs from the memorandum, the following criteria should be considered to determine if adjustments should be proposed.

1. Overall, consider the property's primary use. Is the asset an essential part of the taxpayer's overall theme? Is the asset part of the original plan of construction? Determine by a factual analysis if the hotel/casino complex is elaborate and designed to evoke an extravagant ambiance in addition to being a gambling/hotel facility offering dining, live entertainment, a shopping promenade, swimming pools, a health spa, wedding and banquet facilities, theaters, etc.
 - A. Analyze corporate minutes for the motives for construction or expansion.
 - B. Review city planning commission meeting minutes regarding the proposal.
 - C. Inspect newspaper articles quoting corporate officers regarding the project.
 - D. Determine the features of the instructions to the designing architects.
2. Establish whether each item is a structural component or tangible personal property. The determination whether a structure is inherently permanent requires a consideration of six factors set forth in Whiteco Industries, Inc. v. Commissioner, 65 T.C. 664, 672-73 (1975). Those factors are:
 - A. the manner in which the property is affixed to the real property;
 - B. whether the property was designed to be easily removable or to remain in place indefinitely;
 - C. whether the property has been moved since its initial installation;
 - D. any circumstances that suggest the expected period of affixation (e.g., a lease that requires removal of the property upon its expiration);
 - E. the amount of damage that removal of the property would cause to the property itself or to the real property to which it is affixed; and
 - F. the extent of the effort that is required to remove the property, in terms of time and expense.

The determination of whether a particular item of property is a structural component requires a factual analysis. Obtain architect and engineering contracts for the above categories of construction costs.

3. Determine whether personal property assets fall into Class 79.0, Recreation, contained in Rev. Proc. 87-56, 1987-2 C.B. 674, 686. All depreciable assets used in recreational business activities are included in class 79.0 and are 7-year property unless the taxpayer is subject to alternative minimum tax [Recreational assets in asset class 79.0 have a recovery period of ten years for AMT purposes, I.R.C. § 168 (g) (2) (C) (i)]. Assets in class 57.0, Distributive Trades and Services, have a

recovery period of 5 years for purposes of I.R.C. § 168 (a) and 9 years for purposes of I.R.C. § 168 (g).

4. Review the books and records to determine if the allocated expense for each component reflects appropriate costs.

Review taxpayer documentation for cost allocations. Obtain the general contractor's contract to build which contains the contract amount, project start/completion dates, progress billing procedures, etc. Acquire the specialty subcontractor billings to the general contractor for the above categories of construction costs. Review city and county permits for the above categories of construction costs. Items characterized as indirect should be evaluated to determine if the costs are in fact direct costs.

The uniform capitalization rules require the capitalization of all direct costs and certain indirect costs properly allocable to real property and tangible personal property produced by the taxpayer. Section § 263A(f) requires the capitalization of certain interest expense incurred in connection with the production of property. For purposes of the uniform capitalization rules, to "produce" means to construct, build, install, manufacture, develop, improve, create, raise or grow (§ 263A (g) (1); Reg. § 1.263A (a) (1) (i)). Self-constructed assets and property built under contract are treated as property "produced" by the taxpayer. Therefore, changes to the class life or basis of an asset may require a concurrent adjustment of UNICAP costs. For assistance with UNICAP issues, please contact Jim Peschl, § 263A Technical Advisor, at (763) 549-1020 (James.F.Peschl@irs.gov).

This directive should be applied in the context of other applicable depreciation principles. This memorandum is not an official pronouncement of the law or the Service's position and cannot be used, cited, or relied upon as such.

If you have any questions, please contact Eric Lacher, Gaming Industry Technical Advisor, at (702) 455-1123 (Eric.A.Lacher2@irs.gov).

cc: Commissioner and Deputy Commissioner, LMSB
Director, Performance, Quality and Innovation