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District Director

Taxpayer's Name:
Taxpayer's Address:

Taxpayer's Identification No:
Years Involved:
Date of Conference:

ISSUE:

Whether the cable television distribution plants rebuilt by the taxpayer are real property for purposes of the interest capitalization provisions in § 263A(f) of the Internal Revenue Code.

CONCLUSION:

The cable television distribution plants rebuilt by the taxpayer are inherently permanent structures within the meaning of § 1.263A-8(c)(3) of the Income Tax Regulations, and thus are real property for purposes of § 263A(f).

FACTS:

The taxpayer owns and operates cable television systems in various localities. Each system is operated under a franchise agreement granted by the local political authority having jurisdiction over cable television in the area served by the system.

Cable television systems generally

Cable television systems are individually designed to suit the unique characteristics of each particular location. In general, however, each system consists of two basic components: a headend, which generates the television signals, and a distribution plant, which conveys the television signals from the headend to the subscribers.

The headend obtains television programming from various sources. Some programming is received by antenna from satellite and terrestrial broadcasters; other programming comes from the playback of films or videotapes and from local television studios that produce community access programming. All of these programming sources are fed into the electronic equipment of the headend, which combines the various programs into a multichanneled television signal for distribution to subscribers.

The distribution plant can be configured in various ways. Typically, the signal is first distributed into a limited number of trunk cables, which carry the signal over relatively long distances through the various neighborhoods served by the headend. Within each neighborhood, the signal from the trunk line is fed into a network of feeder (or distribution) cables, which carry the signal past the homes of every subscriber. Finally, the signal is carried from the feeder cables into the individual homes by means of drop cables that tap into the feeder lines.

A group of subscribers served by a single connection to the trunk line is generally known as a "node." The node is used as a unit for many purposes in the design, construction, and operation of a cable television system. In newer cable television systems, each node has a unique connection to the headend, which allows an operator to control the signal to each node independently of the other nodes.

Cables

Distribution plants use two types of cable: coaxial cable and fiber optic cable. Originally, coaxial cable was used exclusively. Current practice favors hybrid systems that use a mixture of coaxial cable and fiber optic cable.

A coaxial cable carries television programs in the form of electrical energy. The cable consists of two electrical conductors – an outer metal tube or braid and an inner metal wire – that are separated by dielectric foam. In some cases, the outer conductor is coated with a protective layer of plastic.

Coaxial cable gradually attenuates an electrical cable signal as it passes through. Amplifiers are used to boost the cable signal when long runs of coaxial cable are used. Each amplifier, however, introduces some additional distortion into the signal. This limits the number of times a signal can be boosted between the headend and the customer while maintaining acceptable signal quality, which in turn limits the total distance that an electrical signal may be sent over coaxial cable.

Coaxial cable is designed to electrically isolate the cable signal within the cable. This is important because cable television and wireless communications systems use overlapping frequencies of electromagnetic waves to transmit information. Without adequate isolation, the cable signal can leak out and disrupt wireless communication, and wireless signals can leak in and interfere with the cable signal. Cable television

systems operators are required by law to maintain their signal leakage below specified levels.

A fiber optic cable carries television programs in the form of light waves. The optical cable signal flows through an optical fiber, which is a tiny continuous tube of glass. An optical fiber does not attenuate an optical cable signal as quickly as a coaxial cable attenuates an electrical cable signal. Consequently, fiber optic cables generally do not require the use of intermittent booster amplifiers as coaxial cables do, and can transmit a clearer signal over longer distances.

A fiber optic cable can carry significantly more information than a coaxial cable. A single fiber optic cable can contain as many as 200 optical fibers, each one of which can carry a separate signal independently of the others. By contrast, a coaxial cable of comparable size can only carry a single signal.

In a typical hybrid system, fiber optic cables are favored over coaxial cables for use as trunk lines. Fiber optic trunk lines allow operators to distribute television signals over long distances with minimal distortion of the signal and without the use of amplifiers. Fiber optic trunk lines also give operators the capacity to distribute a relatively high number of independently programable signals, which allows them to customize the programming sent to different groups of customers. By contrast, coaxial cables are favored over fiber optic cables for use in distribution lines and drop cables. Coaxial cabling is cheaper than fiber optic cabling and is compatible with existing television receivers.

Installation and maintenance

Cables are typically installed along leased rights of way. Installation can be either above ground or below. Above ground installations typically utilize existing utility poles by arrangement with the utilities owning the poles. A load-bearing strand is attached to the poles with bolts and suspension clamps, and the cable itself is then lashed to the strand.

Cable operators perform routine maintenance and repair of their systems on an ongoing basis. Periodically, operators perform a major or complete reconstruction of their systems, which is referred to as a “rebuild” of the system. The decision of when to rebuild a system is affected by numerous considerations, including the physical condition and operating performance of the system, technological changes, desired or required enhancements to the features or functions of the system, the extent of signal leakage from the system overall, and the requirements of the franchise.

Taxpayer rebuilds

The taxpayer begins the process of rebuilding a cable system by completing an

aerial map of the system. A “walk-out” and house count are also performed to determine how many potential customers are in the system. Using the map and the house count data, the taxpayer’s engineering department does a draft design of the system, which is subject to audit and approval by internal management staff. Once the design receives final approval, the physical work of the rebuild begins, most of which is done by outside contractors.

During the taxable years at issue, the taxpayer rebuilt several of its cable systems. Substantially all of the existing cabling was replaced with new cables. Fiber optic cables replaced coaxial cables as trunk lines, except for certain nodes located in close proximity to the headend, known as “headend nodes,” which were served by new coaxial cable trunk lines. Each node in the rebuilt system had its own trunk line channel to the headend (a fiber optic strand for most nodes, or a coaxial trunk line for headend nodes). This independent connection to the headend allowed each node to be placed into service independently of the other nodes.

The complete rebuild of a system, from the beginning of the design process to the completion of construction and testing for the last node, typically lasted two to three years. The amount of time necessary to rebuild an individual node – replacing distribution lines and drop cables – was normally less than one year. The taxpayer placed the rebuilt systems into service on a node by node basis. Each node was placed into service as soon as the trunk line connection to the headend was established and the rebuilding of the distribution and drop cabling within the node was completed.

The taxpayer provided funding for the rebuilds from internal cash flow and did not capitalize any interest under § 263A(f) with respect to the rebuilds.

LAW:

Section 263A(a)(1) provides that, in the case of any property to which § 263A applies, any costs described in § 263A(a)(2) shall be included in inventory costs (in the case of property which is inventory in the hands of the taxpayer), or shall be capitalized (in the case of property that is not inventory in the hands of the taxpayer).

Section 263A(a)(2) provides that the costs described by such paragraph with respect to any property are (i) the direct costs of such property; and (ii) such property’s proper share of those indirect costs (including taxes) part or all of which are allocable to such property.

Section 263A(b)(1) provides that, except as otherwise provided, § 263A applies to real or tangible personal property produced by the taxpayer.

Section 263A(f)(1) provides that § 263A(a) shall only apply to interest costs which (i) are paid or incurred during the production period, and (ii) are allocable to property which is described in § 263A(b)(1) and which has a long useful life, an estimated production period exceeding 2 years, or an estimated production period exceeding 1 year and a cost exceeding $1,000,000.

Section 263A(f)(4)(A) provides that, for purposes of § 263A(f), property has a "long useful life" if such property is real property, or property with a class life of 20 years or more (as determined under § 168).

Section 263A(f)(4)(B) provides that, for purposes of § 263A(f), the term "production period" means, when used with respect to any property, the period beginning on the date on which production of the property begins, and ending on the date on which the property is ready to be placed in service or is ready to be held for sale.

Section 1.263A-8(a)(1) provides that capitalization of interest under the avoided cost method described in § 1.263A-9 is required with respect to the production of designated property described in § 1.263A-8(b).

Section 1.263A-8(b)(1) provides that, except as provided in §§ 1.263A-8(b)(3) and 1.263A-8(b)(4), "designated property" means any property that is produced and that either is (i) real property; or (ii) tangible personal property (as defined by § 1.263A-2(a)(2)) which is (A) property with a class life of 20 years or more under § 168 (long-lived property), but only if the property is not property described in § 1221(1) in the hands of the taxpayer or a related person; (B) property with an estimated production period (as defined in §1.263A-12) exceeding 2 years (2-year property); or (C) property with an estimated production period exceeding 1 year and an estimated cost of production exceeding $1,000,000 (1-year property).

Section 1.263A-8(b)(2) provides that the thresholds described in § 1.263A-8(b)(1) are applied separately for each unit of property as defined in § 1.263A-10.

Section 1.263A-8(c)(1) provides that "real property" includes land, unsevered natural products of land, buildings, and inherently permanent structures.

Section 1.263A-8(c)(3) provides that "inherently permanent structures" include property that is affixed to real property and that will ordinarily remain affixed for an indefinite period of time, such as swimming pools, roads, bridges, tunnels, paved parking areas and other pavements, special foundations, wharves and docks, fences, inherently permanent advertising displays, inherently permanent outdoor lighting facilities, railroad tracks and signals, telephone poles, power generation and transmission facilities, permanently installed telecommunications cables, broadcasting towers, oil and gas pipelines, derricks and storage equipment, grain storage bins and

silos. Property may constitute an inherently permanent structure even though it is not classified as a building for purposes of former § 48(a)(1)(B) and §1.48-1. Any property not otherwise described in § 1.263A-8(c)(3) that constitutes other tangible property under the principles of former § 48(a)(1)(B) and §1.48-1(d) is treated for the purposes of § 1.263A-8 as an inherently permanent structure.

Section 1.263A-8(d)(1) provides that "produce" is defined as provided in §§ 263A(g) and 1.263A-2(a)(1)(i). Section 263A(g)(1) provides that, for purposes of § 263A, the term "produce" includes construct, build, install, manufacture, develop or improve. Section 1.263A-2(a)(1)(i) provides that, for purposes of § 263A, "produce" includes the following: construct, build, install, manufacture, develop, improve, create, raise, or grow.

Section 1.263A-12(c)(1) provides that a separate production period is determined for each unit of property defined in §1.263A-10. Section 1.263A-10(a) provides that whether property is 1-year or 2-year property under §1.263A-8(b)(1)(ii) is also determined separately with respect to each unit of property as defined in § 1.263A-10.

Section 1.263A-10(b)(1) provides that a unit of real property includes any components of real property owned by the taxpayer or a related person that are functionally interdependent and an allocable share of any common feature owned by the taxpayer or a related person that is real property even though the common feature does not meet the functional interdependence test. When the production period begins with respect to any functionally interdependent component or any common feature of the unit of real property, the production period has begun for the entire unit of real property.

Section 1.263A-12(c)(2) provides that the production period of a unit of real property begins on the first date that any physical production activity (as defined in §1.263A-12(e)) is performed with respect to a unit of real property. Section 1.263A-12(e)(1) provides that the term "physical production activities" includes any physical activity that constitutes production within the meaning of §1.263A-8(d)(1).

Section 1.263A-12(c)(3) provides that the production period of a unit of tangible personal property begins on the first date by which the taxpayer's accumulated production expenditures, including planning and design expenditures, are at least 5 percent of the taxpayer's total estimated accumulated production expenditures for the property unit. Thus, the beginning of the production period is determined without regard to whether physical production activity has commenced. The production period for a unit of tangible personal property produced under a contract begins for the customer when the customer's accumulated production expenditures are at least 5 percent of the customer's total estimated accumulated production expenditures.

Section 1.263A-12(d)(1) provides that the production period for a unit of property produced for self use ends on the date that the unit is placed in service and all production activities reasonably expected to be undertaken by, or for, the taxpayer or a related person are completed.

Section 1.263A-10(b)(2) provides that components of real property produced by, or for, the taxpayer, for use by the taxpayer or a related person are functionally interdependent if the placing in service of one component is dependent on the placing in service of the other component by the taxpayer or a related person.

Section 1.263A-10(c) provides that components of tangible personal property are a single unit of property if the components are functionally interdependent. Components of tangible personal property that are produced by, or for, the taxpayer, for use by the taxpayer or a related person, are functionally interdependent if the placing in service of one component is dependent on the placing in service of the other component by the taxpayer or a related person.

ANALYSIS

The issue presented is whether the cable television distribution plants rebuilt by the taxpayer are real property for purposes of the interest capitalization provisions of § 263A(f). Real property is not defined within § 263A, but § 1.263A-8(c)(1) provides that real property includes land, unsevered natural products of land, buildings, and inherently permanent structures. The taxpayer and the examiner agree that a cable television distribution system is not land, an unsevered natural product of land, or a building, and we concur.

Inherently permanent structures

The term “inherently permanent structure” (“IPS”) is defined by § 1.263A-8(c)(3) to include “property that is affixed to real property and that will ordinarily remain affixed for an indefinite period of time.” This definition establishes two basic criteria for an IPS: first, it is affixed to real property; second, it will ordinarily remain affixed for an indefinite period of time.

Cable television distribution plants satisfy the first criterion of an IPS because they are affixed to real property. In underground installations, cables are affixed to real property by burial within the land itself. In aerial installations, cables are affixed to real property by bolting and lashing the cables to utility poles. Such poles are real property because they are affixed to land for an indefinite period of time and thus constitute IPSs. Section 1.263A-8(c)(3) lists “telephone poles” as an example of IPSs.

The second criterion of an IPS requires that the property will ordinarily remain affixed for “an indefinite period of time.” Section 1.263A-8(c)(3) does not expressly

define this term. We believe, however, that in this context an "indefinite period of time" generally means the useful life of the affixed property.

An "indefinite" period of time cannot sensibly be interpreted to mean forever because virtually no property would satisfy that definition, including most, if not all, of the examples of IPSs in § 1.263A-8(c)(3). Similarly, "indefinite" cannot adequately be defined by some arbitrarily chosen minimum period of time because of the inherent variability between and within the various types of IPSs. The examples of IPSs in § 1.263A-8(c)(3) differ considerably in the length of time that the property typically remains affixed to real property, which varies according to the physical characteristics of the affixed property, the location where the affixation occurs, and the mode of affixation. Thus, a tunnel or a roadway typically has a significantly longer period of affixation than a billboard or a silo, while individual examples within each of these general types of IPSs also differ in their periods of affixation according to their individual circumstances.

The term "indefinite," therefore, is best interpreted relative to the useful life of the affixed property. Under this interpretation, an item of property is affixed for an indefinite period of time if the property ordinarily remains affixed for the duration of its useful life. The length of that useful life relative to the useful lives of other items or types of property is not relevant to the determination of whether the property is affixed for an indefinite period. Similarly, the length of the useful life of affixed property in absolute terms is generally not relevant to the determination of whether the property is affixed for an indefinite period, although at some point the useful life of property may be so limited that the property cannot be considered to be affixed for an indefinite period of time, even if it is affixed for the duration of that useful life.

This interpretation of "indefinite" accommodates the inherent variability among and within the various types of IPSs. A silo is an IPS because it ordinarily remains in place for the duration of its useful life. The fact that the useful life of a silo may be shorter or longer than the useful lives of other types of IPSs is not relevant. The possibility that various types of silos may have differing useful lives is similarly irrelevant.

Cable television distribution plants satisfy the second criterion of an IPS under § 1.263A-8(c)(3) because they ordinarily remain affixed to real property for an indefinite period of time under the foregoing interpretation of "indefinite." A cable television cable ordinarily remains in place until the end of its useful life, which may occur because of physical deterioration, technological obsolescence or economic changes. The fact that the useful life of a cable television distribution plant is shorter than the useful lives of some other types of IPSs is not relevant. The evidence presented suggests that the useful life of a cable television plant is at least eight years, which is sufficiently long to allow the conclusion that such property is affixed for an indefinite period.

The definition of an IPS in § 1.263A-8(c)(3) sets forth several examples of IPSs, including "permanently installed telecommunications cables." The phrase "permanently installed" indicates that telecommunications cables are not IPSs unless they satisfy the general definition of IPSs: property affixed to real property for an indefinite period. This apparent redundancy is necessary because the phrase "telecommunications cables" does not by itself imply affixation to real property in the same way as many of the other examples, such as bridges, roads, or paved parking areas.

The phrase "permanently installed" does not establish a standard that is different than, or additional to, the general definition of IPSs in § 1.263A-8(c)(3). First, "permanently installed telecommunication cables" is merely an illustrative example and cannot override the general definition. Second, the same arguments that applied above to determining when affixation is "indefinite" apply equally well to determining whether installation is "permanent." The phrase "permanently installed" cannot mean installed forever or installed for some specific minimum period. Rather, permanence must be defined relative to the useful life of the installed property. A telecommunications cable, therefore, is permanently installed when it is installed for the useful life of the cable.

The taxpayer advances several arguments to show that cable television distribution plants are not IPSs.

First, the taxpayer asserts that cable television cables cannot be "indefinitely" affixed or "permanently" installed because they have a relatively short useful life. As argued above, however, whether property is indefinitely affixed or permanently installed is determined by whether the property ordinarily remains affixed to real property for the useful life of the affixed property, whatever the length of that useful life may be. Thus, the assertedly short useful life of cable television cables relative to other types of property is not relevant to determining whether such cable television distribution plants are IPSs.

Second, the taxpayer argues that cable television cables cannot be IPSs because they must be removed so frequently from the real property to which they are affixed. The reasons for removal include the physical exhaustion of the cable, the technological or economic obsolescence of the cable, and the relocation of cable routes as mandated by the local authorities or the lessors of the rights of way. This argument, however, conflates two different purposes of removing property: to retire it from service, or to relocate it for additional service in another location. These two purposes have different consequences for the determination of whether property is an IPS.

The first purpose -- to retire property from service -- is not inconsistent with characterizing the removed property as an IPS. For example, an advertising display that ordinarily remains affixed to real property for its useful life is an IPS, even though it may, and probably will, be removed at the end of its useful life. By contrast, the second purpose -- to relocate property for additional service in another location -- is inconsistent

with characterizing the removed property as an IPS. An advertising display that is frequently moved from place to place during its useful life is not an IPS because it does not ordinarily remain affixed to real property for its useful life.

Cable television cables are most often removed from real property in order to retire the cables from service at the end of their useful lives. Such removal is not inconsistent with characterization of the cables as IPSs. Cable television cables are rarely removed in order to move them to another location for additional service. Cable routes do change, as the taxpayer points out, but the rerouting is usually not accomplished by moving existing cable from the old route to the new. This would disrupt service to subscribers and require an extensive reworking of the cable, which is cut and spliced to fit the circumstance of the existing route. Instead, rerouting is usually accomplished by two separate activities: installing new cable along the new routes and removing (or abandoning) the existing cable along the old routes to retire it from service.

Accordingly, the asserted frequent removal of cable television cables does not preclude classification of these cables as IPSs because the removal is most often performed to retire the cable from service rather than to relocate it for additional service.

Third, the taxpayer argues that cable television cables cannot be IPSs because the mode of affixing the cables to real property is so weak and easily reversible that it cannot constitute permanent installation or indefinite affixation. In the case of aerial installations, the taxpayer notes, a technician can detach the cable and supporting strand from the pole in 45 to 90 seconds.

The definition of an IPS in § 1.263A-8(c)(3) suggests two basic requirements for the means of affixing an IPS to real property. First, the means of affixation must be sufficiently strong to ordinarily secure the property for the duration of its useful life. Second, the means of affixation must not be designed or intended to facilitate the movement of the property during its useful life. For example, a portable billboard mounted on wheels and held in place with ropes and stakes would not be an IPS because it violates both of these requirements.

But nothing in the definition of an IPS requires in addition that the means of affixation be difficult or impossible to reverse. Many types of IPSs are in fact difficult to remove. Physically massive IPSs, such as bridges or broadcasting towers, are affixed by means of pilings or foundations and require powerful, often destructive, force to reverse the affixation. The difficulty in removing these IPSs, however, is a consequence of their particular physical characteristics rather than a requirement in the definition of an IPS. An IPS that requires less effort to install for its useful life would logically require less effort to remove at the end of such life.

The bond created by bolting a cable to a pole is sufficiently strong to ordinarily secure the cable for the duration of its useful life. Bolting is used because it is an economically efficient means of accomplishing this goal, not because it facilitates movement of the cable during its useful life, which, as discussed above, is rarely done. Given these facts, it is not relevant that removing a bolted cable may require less strenuous efforts than removing other types of IPSs.

The 90-second statistic, moreover, is misleading. Unbolting a cable from a single pole does not in itself detach a cable television distribution plant, or any material part thereof, from the ground, any more than removing a single crosstie removes a rail line. The same operation must be performed hundreds of times at different locations to accomplish a removal, and the cumulative time spent and expenses incurred are comparable to the removal of property affixed in a more robust manner, such as foundations or pilings.

Fourth, the taxpayer argues that a cable television distribution plant cannot be an IPS because the cables are typically installed along leased rights of way, and the lessor may order removal of the cable at its discretion. As discussed above, rerouting of cables is ordinarily accomplished by retiring the old cable from the old route and installing new cable along the new route. Thus, the possibility that a lessor may order removal of a cable arguably shortens the expected useful life of the cable. But, as discussed above, the length of the cable's useful life is not relevant to its status as an IPS, so long as the cable ordinarily remains affixed for the duration of such life.

Fifth, the taxpayer argues that a cable television distribution plant cannot be an IPS because cable television cables are not telecommunications cables within the meaning of "permanently installed telecommunications cables" in § 1.263A-8(c)(3). The taxpayer's argument implicitly treats "permanently installed telecommunications cables" as the exclusive example of communications cables qualifying as IPSs.

The taxpayer states that cable television is not "telecommunications" within the meaning of the Communications Act of 1934, as amended ("the Communications Act", 47 U.S.C.A. (West Supp. 1999)). The Communications Act defines telecommunications as "the transmission, between or among points specified by the user, of information of the user's choosing, without change in the form or content of the information as sent and received." 47 U.S.C.A. 153(43). By contrast, cable service is defined to be the one-way transmission to subscribers of video programming or other programming service and the subscriber interaction, if any, which is required for the selection or use of such video programming or other programming service. 47 U.S.C.A. §§ 153(7), 522(6). Cable television cannot be telecommunications, therefore, because it lacks the essential attributes of telecommunications: a two-way transmission on a common-carrier basis of user specified content.

The taxpayer argues that the Communications Act definition of

telecommunications should control § 1.263A-8(c)(3) because this definition has been incorporated into the asset classification scheme of the Modified Accelerated Cost Recovery System (MACRS). The asset classifications in MACRS, taxpayer asserts, consistently reflect the distinction between property that is used in telecommunications as defined by the Communications Act and property that is not. Thus, asset class 48.14 (Telephone Distribution Plant) is defined by reference to accounts within the Federal Communications Commission Uniform System of Accounts ("FCC USOA") that embody the Communications Act definition of telecommunications. By contrast, asset classes relating to "Cable Television (CATV)", including 48.42 (Subscriber Connection and Distribution Systems), expressly exclude assets that are "used to provide subscribers with two-way communications services." Asset classes relating to "Telegraph, Ocean Cable and Satellite Communications (TOSC)" that are comparable to telephone distribution plant assets in class 48.14 are assigned the same class life as class 48.14 assets, provided that they are used for 2-way exchange of voice and data communication which is the equivalent of telephone communications. Rev. Proc. 87-56, 1987-2 C.B. 674.

The taxpayer points out that the MACRS distinction between telecommunications and nontelecommunications assets corresponds to a physical difference between these two types of assets. Telecommunications assets, chiefly telephone wires, are made of simpler and sturdier materials (copper wire) than nontelecommuncations assets (coaxial cable and fiber optic cables), are less susceptible to damage and deterioration of various kinds, and enjoy a longer useful life. Accordingly, telecommunications assets are assigned longer class lives.

Despite taxpayer's arguments, we believe that it is more appropriate to construe "telecommunications" in § 1.263A-8(c)(3) in accord with its everyday meaning, which includes cable television service. In general, the words of a revenue provision should be given their common and ordinary meaning. Commissioner v. Soliman, 506 U.S. 168, 174 (1993); Commissioner v. Korell, 339 U.S. 619, 627-8 (1949). This instance presents no persuasive reasons to depart from this general rule.

The Communications Act and the FCC USOA embody federal communications policy. The concepts developed therein are not necessarily relevant to federal tax policy and should not be automatically incorporated into the tax law without some indication that such incorporation was intended. For example, in the case of MACRS, Rev. Proc. 87-56 explicitly refers to the FCC USOA and includes substantive provisions that echo the special meaning of telecommunications in the Communications Act. Section 1.263A-8(c)(3), however, contains no explicit reference to the Communications Act, the FCC USOA, or any other extrinsic source that uses the more specialized sense of telecommunications.

The incorporation of the Communications Act conception of telecommunications into MACRS does not in itself warrant the wholesale incorporation of this concept into

all other areas of the tax law. Different areas of the tax law have different purposes and concerns, and thus a term of art from an extrinsic source may be very useful and appropriate for one area but unsuited or irrelevant for others.

The concept of telecommunications was imported into MACRS from the Communications Act as an expedient way to define asset classes. The taxpayer implies this was done because the distinction between telecommunications and nontelecommunications industries corresponds to a difference in the length of the useful lives of the assets used, which is a relevant issue for MACRS. As discussed above, however, the useful life of assets is not a relevant concern in determining whether property is an IPS under § 1.263A-8(c)(3). Thus the apparent rationale for incorporating the Communications Act conception of telecommunications into MACRS is inapplicable to § 1.263A-8.

Finally, we note that incorporating the Communications Act concept of telecommunications into § 1.263A-8 would result in classifying a cable as an IPS based upon the content transmitted within the cable, which is not a relevant consideration to determining whether the cable will ordinarily remain affixed for the duration of its useful life. The taxpayer believes the distinction between two-way and one-way communications is relevant because it presently corresponds to a difference in physical type and useful lives of the assets utilized in these two different activities, but this correspondence may be breaking down as technology changes.

Imagine, for example, that cable system A is rebuilt to offer only one-way video, while cable system B is rebuilt to offer video and telephony. Under taxpayer's analysis, system A would be characterized as real property for purposes of § 263A(f) while system B would be characterized as tangible personal property, even though similar cabling would be used in both systems. This anomalous result underscores that the Communications Act concept of telecommunications and the two-way/one-way distinction are irrelevant to interest capitalization under § 263A(f).

In sum, cable television distribution systems satisfy the basic criteria of an IPS in § 1.263A-8(c)(3) because they are affixed to real property and ordinarily remain affixed for an indefinite period. In addition, such systems constitute "permanently installed telecommunications cables," which are expressly identified as examples of IPSs. Accordingly, cable television distribution systems are inherently permanent structures within the meaning of § 1.263A-8(c)(1).

In addition to the general definition of IPSs and the listed examples, § 1.263A-8(c)(3) also provides that "any property not otherwise described in this paragraph (c)(3) that constitutes other tangible property under the principles of former section 48(a)(1)(B) and § 1.48-1(d) is treated for purposes of this section as an inherently permanent structure." Because we have concluded that cable television distribution plants satisfy the general definition of IPSs, we do not need to address this provision.

We believe, however, that cable television distribution systems may constitute other tangible property under former § 48(a)(1)(B) and § 1.48-1(d). Cf. Rev. Rul. 72-398, 1972-2 C.B. 9; Whiteco Industries v. Commissioner, 65 T.C. 664 (1975).

Units of property and production periods

The amount of interest capitalized under § 263A(f) is calculated with respect to individual units of property and their production periods. Although guidance regarding the unit of property and the production period was not specifically requested, we include the following observations for the benefit of the taxpayer and the examiner.

The unit of property in a cable television distribution system rebuilt by the taxpayer appears to be the node. Section 1.263A-10(b)(1) provides that a unit of real property includes any components of real property owned by the taxpayer or related persons that are functionally interdependent plus an allocable share of any common feature(s). The facts indicate that the elements within a node are largely functionally interdependent; these elements either cannot be, or rarely are, placed into service independently of one another. Each node, however, is functionally independent of the other nodes because it can be placed in and out of service and otherwise manipulated independently of the other nodes.

Trunk lines might plausibly be treated as common features with respect to nodes. Trunk lines do provide benefits (television signals) to the nodes, but they are also functionally interdependent with the nodes they serve because neither a trunk line nor the associated nodes can be placed into meaningful service without the other being placed into service as well. It may be preferable, therefor, to treat a trunk line as set of components, each of which belongs to one of the nodes served by the line. This treatment parallels physical reality because each node is in fact connected to the headend by a distinct fiber optic strand.

The production period of a node begins when any physical production activity is performed with respect to the node or the trunk line serving the node. Under § 1.263A-12(c)(2), the production period for a unit of real property begins with the onset of physical activity on the unit. Physical activity on a trunk line that serves a node starts the production period with respect to such node because the trunk line is either (i) a functionally interdependent component of the node, or (ii) a common feature with respect to such node, depending upon the chosen analysis. § 1.263A-10(b)(1).

The production period ends when the node is placed into service and all production activities reasonably expected to be undertaken by, or for, the taxpayer are completed. § 1.263A-12(d).

Cables as personal property

Finally, we note that even if cable television distribution systems were treated purely as personal property, it is likely that some interest should be capitalized with respect to the systems rebuilt by the taxpayer. The unit of property would remain the node, and the trunk line would consist of multiple components belonging to the various nodes served by the line. § 1.263A-10(c). The production period of a node would begin on the first date that the accumulated production expenditures (APEs), including planning and design expenditures, are at least 5% of the total estimated APEs for the node. § 1.263A-12(c)(3). The production period ends when the node is placed into service and all production activities reasonably expected to be undertaken by, or for, the taxpayer are completed. § 1.263A-12(d).

Under these principles, the production period of a node in a system rebuilt by the taxpayer would start in the planning and design phase if at least 5 per cent of total costs of that node were incurred in this phase, which seems plausible. The production period of such node would end when it was placed into service and all production activities had ended. Because the overall process of rebuilding a system – from planning and design through the end of production – lasted two to three years, it is likely that some nodes would have had a production period of two years or more. Such nodes would be subject to interest capitalization without regard to the amounts of their total estimated costs. §§ 263A(f)(1)(B)(ii); 1.263A-8(b)(1)(ii)(B).