

INTERNAL REVENUE SERVICE  
NATIONAL OFFICE TECHNICAL ADVICE MEMORANDUM

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CASE-MIS No.: TAM-134796-15

Taxpayer's Name:  
Taxpayer's Address:

Taxpayer's Identification No  
Year(s) Involved:  
Date of Conference:

LEGEND:

Taxpayer =

ISSUE:

Whether substantial renovation, construction, or erection of  
, and

qualify as construction of real property so that gross receipts from such projects qualify as domestic production gross receipts (DPGR) under § 1.199-3(m) of the Income Tax Regulations?

CONCLUSION:

Yes. Projects where the Taxpayer's activities qualify as substantial renovation, construction, or erection of , and constitute construction of real property, and gross receipts from such projects qualify as DPGR under § 1.199-3(m).

FACTS:

**A. Overview**

Taxpayer engages in a trade or business that is considered construction for purposes of the North American Industry Classification System (NAICS) on a regular and ongoing basis. Taxpayer is a U.S. national construction contractor primarily serving the

and related industries. Generally,

Taxpayer engages in all phases of field construction including direct hire of most labor crafts, construction engineering, welding, rigging engineering, estimating, subcontractor management, field procurement, planning and scheduling, project controls, quality and safety, crane work, foundational work, ground preparation work, water systems, and/or other construction. Specific activities performed for each job vary from project to project.

Taxpayer utilizes traditional construction and craft labor resources. Taxpayer uses cranes, trucks, bulldozers, backhoes, temporary power generation and lighting arrays, scaffolding, weld equipment, field tools, safety equipment and construction tackle in its activities.

LB&I and Taxpayer requested Technical Advice on the qualification (for § 199 purposes) of gross receipts that Taxpayer derived from projects related to the substantial renovation, construction, or erection of , , and in the United States.

Taxpayer does not receive any income or gross receipts from the actual sale of these units. Taxpayer's gross receipts are derived from various projects that involve installing or replacing components of and and erecting at the sites.

**B.**

For projects, Taxpayer does not erect new . Instead, Taxpayer renovates major components and substantial structural parts of the . The renovations either materially increase the value of the , substantially prolong the useful life of the , or both.

An is commonly used by to

The \_\_\_\_\_ consists of a series of large piping; ancillary equipment, including pumps, motors, heaters, heat exchangers, separators, and reboilers; and \_\_\_\_\_ main vessels:

\_\_\_\_\_ operate continuously \_\_\_\_\_ hours a day for approximately \_\_\_\_\_ to \_\_\_\_\_ years between scheduled shutdowns for routine maintenance.

Generally, \_\_\_\_\_ structures are \_\_\_\_\_ feet tall by \_\_\_\_\_ feet wide by \_\_\_\_\_ feet long. An entire \_\_\_\_\_ unit can weigh as much as \_\_\_\_\_ tons, with components ranging in weight from \_\_\_\_\_ tons to \_\_\_\_\_ tons. \_\_\_\_\_ vessels range in size from \_\_\_\_\_ to \_\_\_\_\_ feet in diameter.

\_\_\_\_\_ components are attached to support columns, and are installed above ground for environmental and maintenance reasons. The support columns are much heavier than the frame of a building. The main supports weigh \_\_\_\_\_ pounds per foot. \_\_\_\_\_ generally rest on concrete foundations. The components of \_\_\_\_\_ have different spread footings, and therefore each component has a different foundation. The support columns rest on top of these foundations and are secured by anchor bolts imbedded in the concrete. Each foundation is designed to support over \_\_\_\_\_ tons and multiple foundations of this size are necessary to accommodate the entire \_\_\_\_\_. The \_\_\_\_\_ is designed to withstand harsh weather.

Preparation for foundation and ground work may take as long as four to twelve months. During this period, new \_\_\_\_\_ components are constructed, which generally require a crew of \_\_\_\_\_ employees working \_\_\_\_\_ to \_\_\_\_\_ weeks to complete. The components are assembled on-site with the use of heavy construction equipment and large capacity cranes. \_\_\_\_\_ components are welded, bolted, or otherwise permanently affixed to the support columns and foundations.

Generally, \_\_\_\_\_ have a useful life of \_\_\_\_\_ to \_\_\_\_\_ years without significant maintenance. The \_\_\_\_\_ vessels have access openings and stairs inside to allow maintenance people to visually inspect the interior of the vessels. Large cranes are necessary to access the upper sections of the \_\_\_\_\_ for maintenance. The vessels generally are repaired, but rarely replaced. Ancillary equipment, however, can be separately disassembled, replaced, and repaired as it wears out. When components of \_\_\_\_\_ are retired from service, Taxpayer dismantles the \_\_\_\_\_ components, picks them up with a crane, and takes them off-site for demolition. However, demolition of an entire \_\_\_\_\_ is rare. Some of the first \_\_\_\_\_ built (circa \_\_\_\_\_) currently operate today. If a \_\_\_\_\_ ceases operations, it requires a great amount of work to remove the insulation and to clean the steel before disposing of the \_\_\_\_\_. To Taxpayer's knowledge, \_\_\_\_\_ are not moved to a different site for reuse.

## C.

For projects, Taxpayer does not erect new . Taxpayer renovates major components and substantial structural parts of the . The renovations either materially increase the value of the , substantially prolong the useful life of the , or both.

A is a that

A may be feet tall and consists of tandem pairs of installed at elevations of or stories, each of which may be over feet in diameter. Most have . In general, a weighs lbs. while the framework on top of the may weigh approximately lbs.

and structures have many similarities and thus require similar foundations. A is installed on large reinforced I-Beam supports and connects to large concrete footings. Like for , preparation for foundation and ground work for may take as long as four to twelve months. During this period, new are constructed and generally require a crew of employees working to weeks to complete. may be delivered to the construction site in pieces where they are connected together, or the complete may be delivered to the site and erected on-site with the use of heavy construction equipment and large capacity cranes. Permanent affixation to the support structures and concrete foundation occurs through bolting, welding, or similar methods.

Generally, have a useful life of more than years with renovations performed every to years. The can be replaced when they wear out, but on-site assembly may be required to complete their construction. When components of are retired from service, Taxpayer similarly dismantles the pieces, picks them up with a crane, and takes them off-site for demolition. However, demolition and removal of an entire rarely occurs, and are not moved to new sites for reuse.

## D.

Taxpayer's projects involved the new erection of at plants and complexes.

In general, an \_\_\_\_\_ is an \_\_\_\_\_ that

\_\_\_\_\_. The \_\_\_\_\_ generally does not have moving parts. There are several different types of \_\_\_\_\_ configurations based on the type of application.

One common application for an \_\_\_\_\_ is use in a \_\_\_\_\_ plant. The components of a \_\_\_\_\_ plant include \_\_\_\_\_. In such a plant, the \_\_\_\_\_ generates \_\_\_\_\_ . A system of piping carries \_\_\_\_\_ from this process and \_\_\_\_\_ to the \_\_\_\_\_ , where

A typical \_\_\_\_\_ is made up of various equipment and control components, including

\_\_\_\_\_ can vary in size depending on the project, but generally are very large and heavy. In a \_\_\_\_\_ plant, the \_\_\_\_\_ serves as

\_\_\_\_\_. Generally, \_\_\_\_\_ range from: (1) small \_\_\_\_\_ – \_\_\_\_\_ feet by \_\_\_\_\_ feet by \_\_\_\_\_ feet; (2) medium \_\_\_\_\_ – \_\_\_\_\_ feet by \_\_\_\_\_ feet by \_\_\_\_\_ feet; (3) large \_\_\_\_\_ – \_\_\_\_\_ feet by \_\_\_\_\_ feet by \_\_\_\_\_ feet. The total steel weight and the size of the \_\_\_\_\_ need to meet the specific design as well as impact from \_\_\_\_\_ design criteria. Generally, the weights associated with the sizes above include: (1) small \_\_\_\_\_ – \_\_\_\_\_ pounds; (2) medium – \_\_\_\_\_ pounds; or (3) large \_\_\_\_\_ – \_\_\_\_\_ pounds.

Taxpayer affixes \_\_\_\_\_ to a concrete foundation that is several feet thick, with a perimeter that spans several feet beyond the footprint of the \_\_\_\_\_. The thickness of the foundation depends on the size of the \_\_\_\_\_ and the \_\_\_\_\_ design criteria. \_\_\_\_\_ require the support of several integral beams and columns, which form the structural backbone for the entire \_\_\_\_\_. These columns sit on base plates embedded in the concrete anchored by means of anchor bolts.

Taxpayer generally requires a crew of \_\_\_\_\_ direct craft personnel and \_\_\_\_\_ indirect personnel when constructing a new \_\_\_\_\_. New \_\_\_\_\_ are constructed with heavy construction equipment and specialty cranes generally on-site which occurs concurrently with the construction of the \_\_\_\_\_ plant. Portions of the \_\_\_\_\_ units may be assembled off-site and transported, then rigged and constructed at the customer's site. \_\_\_\_\_ are attached to and integrated with the \_\_\_\_\_ plant.

Generally, the useful life of an \_\_\_\_\_ may extend as long as \_\_\_\_\_ years, with maintenance and replacement of components occurring periodically. The demolition and removal of an entire \_\_\_\_\_ is rare. Taxpayer may scrap \_\_\_\_\_ at the end of their useful lives. To Taxpayer's knowledge, \_\_\_\_\_ are not moved to a different site for reuse.

LAW:

### Section 199

Section 199(c)(4)(A)(ii) of the Internal Revenue Code defines DPGR to include the gross receipts of the taxpayer which are derived from, in the case of a taxpayer engaged in the active conduct of a construction trade or business, construction of real property performed in the United States by the taxpayer in the ordinary course of such trade or business.

Section 1.199-3(d)(1)(i) defines the term "item" as the property offered by the taxpayer in the normal course of the taxpayer's business for lease, rental, license, sale, exchange, or other disposition (collectively "disposition"), if the gross receipts from the disposition of such property qualify as DPGR.

Section 1.199-3(d)(2)(iii) provides that for purposes of § 1.199-3(d)(1), in the case of construction activities and services or engineering and architectural services, a taxpayer may use any reasonable method that is satisfactory to the Secretary based on all of the facts and circumstances to determine what construction activities and services or engineering or architectural services constitute an item.

Section 1.199-3(m)(1)(i) defines the term "construction" to mean activities and services relating to the construction or erection of real property (as defined in § 1.199-3(m)(3)) in the United States by a taxpayer that, at the time the taxpayer constructs the real property, is engaged in a trade or business (but not necessarily its primary, or only, trade or business) that is considered construction for purposes of the North American Industry Classification System (NAICS) on a regular and ongoing basis. A trade or business that is considered construction under the NAICS means a construction activity under the two-digit NAICS code of 23 and any other construction activity in any other NAICS code provided the construction activity relates to the construction of real property such as NAICS code 21311 (drilling oil and gas wells) and 213112 (support activities for oil and gas operations). For purposes of § 1.199-3(m), the term "construction project" means the construction activities and services treated as the item under § 1.199-3(d)(2)(iii). Tangible personal property (for example, appliances, furniture, and fixtures) that is sold as part of a construction project that is not considered real property for purposes of § 1.199-3(m)(1)(i). In determining whether property is real property, the fact that property is real property under local law is not controlling.

Conversely, property may be real property for purposes of § 1.199-3(m)(1)(i) even though under local law the property is considered tangible personal property.

Section 1.199-3(m)(2)(i) describes activities constituting construction as activities performed in connection with a project to erect or substantially renovate real property including activities performed by a general contractor, for example, activities relating to the management and oversight of the construction process such as approvals, periodic inspection of the progress of the construction project, and required job modifications.

Section 1.199-3(m)(3) defines “real property” to mean buildings (including items that are structural components of such buildings), inherently permanent structures (as defined in § 1.263A-8(c)(3)) other than machinery (as defined in § 1.263A-8(c)(4)) (including items that are components of such inherently permanent structures), inherently permanent land improvements, oil and gas wells, and infrastructure (as defined in § 1.199-3(m)(4)). For purposes of the preceding sentence, an entire utility plant including both the shell and the interior will be treated as an inherently permanent structure. Property produced by a taxpayer that is not real property in the hands of that taxpayer, but that may be incorporated into real property by another taxpayer, is not treated as real property by the producing taxpayer (for example, bricks, nails, paint, and windowpanes). For purposes of § 1.199-3(m)(3), structural components of buildings and inherently permanent structures include property such as walls, partitions, doors, wiring, plumbing, central air conditioning and heating systems, pipes and ducts, elevators and escalators, and other similar property.

Section 1.199-3(m)(5) defines “substantial renovation” as the renovation of a major component or substantial structural part of real property that materially increases the value of the property, substantially prolongs the useful life of the property, or adapts the property to a new or different use.

Section 1.199-3(m)(6)(i) provides, assuming all of the requirements of § 1.199-3(m) are met, DPGR derived from the construction of real property performed in the United States includes the proceeds from the sale, exchange, or disposition of real property constructed by the taxpayer in the United States (whether or not the property is sold immediately after construction is completed and whether or not the construction project is completed). DPGR derived from the construction of real property includes compensation for the performance of construction services by the taxpayer in the United States. DPGR derived from the construction of real property includes gross receipts derived from materials and supplies consumed in the construction project or that become part of the constructed real property, assuming all requirements of § 1.199-3(m) are met.

#### Section 263A

Section 1.263A-8(c)(3) defines “inherently permanent structures” as follows:

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. For purposes of this section, affixation to real property may be accomplished by weight alone. Property may constitute an inherently permanent structure even though it is not classified as a building for purposes of former section 48(a)(1)(B) and § 1.48-1. 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 the purposes of this section as an inherently permanent structure.

Section 1.263A-8(c)(4) provides the following with respect to machinery:

(i) Treatment. A structure that is property in the nature of machinery or is essentially an item of machinery or equipment is not an inherently permanent structure and is not real property. In the case, however, of a building or inherently permanent structure that includes property in the nature of machinery as a structural component, the property in the nature of machinery is real property.

(ii) Certain factors not determinative. A structure may be an inherently permanent structure, and not property in the nature of machinery or essentially an item of machinery, even if the structure is necessary to operate or use, supports, or is otherwise associated with, machinery.

#### ANALYSIS:

Under § 199(c)(4)(A)(ii), Taxpayer's gross receipts are DPGR if Taxpayer derived gross receipts from the construction of real property performed in the United States while engaged in the active conduct of a construction trade or business. Section 1.199-3(m)(6)(i) provides, assuming all of the requirements of § 1.199-3(m) are met, DPGR derived from the construction of real property performed in the United States includes compensation for the performance of construction services by the taxpayer in the United States.

Under § 199, the term "item" generally means the property offered by the taxpayer in the normal course of the taxpayer's business for disposition, if the gross receipts from the disposition of such property qualify as DPGR. Section 1.199-3(d)(2)(iii) provides a



special rule for construction activities. It provides that a taxpayer engaged in construction activities may use any reasonable method that is satisfactory to the Secretary based on all of the facts and circumstances to determine what construction activities and services constitute an item.

Taxpayer claims that it performs substantial renovation, construction, or erection of \_\_\_\_\_, \_\_\_\_\_, and \_\_\_\_\_, that these activities are construction of real property for § 199 purposes, and that gross receipts from each project are DPGR under § 1.199-3(m). Taxpayer claims it is reasonable to consider each project as an “item” for purposes of section 199 because Taxpayer’s activities relate to the construction of real property in the United States. LB&I’s position is that Taxpayer’s activities performed on \_\_\_\_\_, \_\_\_\_\_, and/or \_\_\_\_\_ do not qualify as the construction of real property for § 199 purposes because \_\_\_\_\_, \_\_\_\_\_, and \_\_\_\_\_ are tangible personal property. Accordingly, LB&I concluded that it is not reasonable for Taxpayer to treat each project as an item for purposes of determining DPGR under § 1.199-3(d)(2).

Section 1.199-3(m)(2)(i) describes activities constituting construction as activities performed in connection with a project to erect or substantially renovate real property. While LB&I and Taxpayer have addressed other issues in their respective submissions, both agree that if the \_\_\_\_\_, \_\_\_\_\_, and \_\_\_\_\_ are real property for § 199 purposes, then Taxpayer’s activities are construction activities under § 1.199-3(m)(2)(i) and gross receipts from the qualified projects are DPGR assuming Taxpayer meets the other § 199 requirements.

Therefore, the question is whether the \_\_\_\_\_, \_\_\_\_\_, and \_\_\_\_\_ are “real property” under § 1.199-3(m)(3). Section 1.199-3(m)(3) provides that “real property” includes “inherently permanent structures (as defined in § 1.263A-8(c)(3)) other than machinery (as defined in § 1.263A-8(c)(4)) (including items that are structural components of such inherently permanent structures).”<sup>1</sup> As this is a cross-reference to §§ 1.263A-8(c)(3) and (4), the determination under those sections controls for purposes of determining whether the \_\_\_\_\_, \_\_\_\_\_, and \_\_\_\_\_ are real property for purposes of § 1.199-3(m)(3).

Section 1.263A-8(c)(3) sets forth the general definition of “inherently permanent structures.” Section 1.263A-8(c)(4) specifies that “a structure that is property in the nature of machinery or is essentially an item of machinery or equipment” (hereinafter, “machinery”) is “not an inherently permanent structure” and is “not real property.” We believe that the purpose of § 1.263A-8(c)(4) is to clarify that machinery and inherently permanent structures are mutually exclusive categories of property. The scope of machinery under § 1.263A-8(c)(4) is therefore limited in that it does not include any

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<sup>1</sup> Taxpayer and LB&I agree that the \_\_\_\_\_, \_\_\_\_\_, and \_\_\_\_\_ do not constitute any other type of real property specified in § 1.199-3(m)(3), such as buildings, infrastructure, or utility plants. Therefore, we do not analyze whether the \_\_\_\_\_, \_\_\_\_\_, and \_\_\_\_\_ qualify as these other types of real property.

property that qualifies as an inherently permanent structure under § 1.263A-8(c)(3). We do not think that § 1.263A-8(c)(4) establishes an additional requirement whereby property that qualifies as an inherently permanent structure under § 1.263A-8(c)(3) may be removed from such classification as an inherently permanent structure if it is machinery under § 1.263A-8(c)(4). As a result, if the \_\_\_\_\_, \_\_\_\_\_, and \_\_\_\_\_ satisfy the definition of inherently permanent structures under § 1.263A-8(c)(3), they are “real property” for purposes of § 1.199-3(m)(3).

#### Inherently Permanent Structures Under § 1.263A-8(c)(3)

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.” This definition establishes two basic requirements for an inherently permanent structure, both of which must be satisfied: first, the structure must be affixed to real property; second, the structure must ordinarily remain affixed for an indefinite period of time. Section 1.263A-8(c)(3) illustrates this definition through numerous examples.

Section 1.263A-8(c)(3) uses the term “affixed to real property” for its ordinary and common meaning, that is, physically connected or attached. Section 1.263A-8(c)(3) specifies that affixation to real property may be accomplished by weight alone. Where a structure is affixed to real property by weight alone, additional evidence of attachment to real property is not required. Additional evidence may include embedding a structure in the ground or mounting a structure to a foundation. If installation of the structure involves the use of construction machinery and equipment, attachment to real property may be indicated. See CCA 201302017 (Jan. 11, 2013).

The \_\_\_\_\_, \_\_\_\_\_, and \_\_\_\_\_ satisfy this first criterion of an inherently permanent structure on the basis of their weight alone; however, these units also evidence affixation to real property through their attachment to concrete foundations and support work. The \_\_\_\_\_, \_\_\_\_\_, and \_\_\_\_\_ are enormously large and heavy structures. They typically stand over \_\_\_\_\_ feet in height and weigh hundreds or even thousands of tons. They each require significant foundations and other groundwork, as well as concrete support beams and columns. The construction of these foundations and other groundwork is accomplished through the use of heavy construction equipment and large capacity cranes over a period of approximately \_\_\_\_\_ to \_\_\_\_\_ months. The \_\_\_\_\_, \_\_\_\_\_, and \_\_\_\_\_ are then constructed on-site over a period of approximately \_\_\_\_\_ to \_\_\_\_\_ weeks using heavy construction equipment and large capacity cranes, and finally welded, bolted, or affixed through similar methods to the foundations and support columns. Thus, \_\_\_\_\_, \_\_\_\_\_, and \_\_\_\_\_ satisfy the first criterion of an inherently permanent structure under § 1.263A-8(c)(3) because they are affixed to real property through both their weight, as well as their attachment to the concrete foundations and support work through welding, bolting, or other affixation.

The second criterion of an inherently permanent structure requires that the property “will ordinarily remain affixed for an indefinite period of time.” Section 1.263A-8(c)(3) does not expressly define the term “indefinite,” and so we are required to apply a reasonable interpretation. Accordingly, we interpret the phrase according to its ordinary and common meaning to mean the useful life of the affixed property. See CCA 200101003 (Aug. 31, 2000). An “indefinite” period of time cannot reasonably be interpreted to mean forever because virtually no property would satisfy that definition. If the term were interpreted to mean forever, that would exclude most, if not all, of the examples of inherently permanent structures described in § 1.263A-8(c)(3).

The length of the affixed property’s useful life relative to the useful lives of other items or types of property is also not relevant to the determination of whether the property is affixed for an indefinite period. The examples of inherently permanent structures in § 1.263A-8(c)(3) vary considerably in the length of time that the property typically remains affixed to real property, depending on the physical characteristics of the affixed property, the location where the affixation occurs, and the mode of affixation. For example, a fence may have a relatively short useful life, whereas a tunnel may have a relatively long useful life. It is reasonable to assume that these examples reflect an appropriate range of anticipated affixation. The term “indefinite,” therefore, is best interpreted to mean that the property is affixed to real property for the useful life of the property, or the period during which the property remains in operating condition and serves a useful function at its installation site. This interpretation of “indefinite” accommodates the inherent variability among and within the various types of inherently permanent structures.

The \_\_\_\_\_, \_\_\_\_\_, and \_\_\_\_\_ satisfy the second criterion of an inherently permanent structure under § 1.263A-8(c)(3) because they ordinarily remain affixed to real property for an indefinite period of time (i.e., the duration of their useful lives). The facts provided indicate that the function of the \_\_\_\_\_ and \_\_\_\_\_ is to \_\_\_\_\_, and the function of the \_\_\_\_\_ is to \_\_\_\_\_. These units have useful lives of several decades, provided the required maintenance is performed. Thus, their useful lives fall in the middle of the range provided by the examples in § 1.263A-8(c)(3). The \_\_\_\_\_, \_\_\_\_\_, and \_\_\_\_\_ remain affixed to real property for the duration of their useful lives, from the time they are installed through the end of their useful lives, as evidenced by the fact that they are typically abandoned in place. Thus, similar to the examples of inherently permanent structures in § 1.263A-8(c)(3), these units generally remain affixed to real property for the duration of the period during which they remain in operating condition and serve a useful function at their installation sites. Accordingly, \_\_\_\_\_, \_\_\_\_\_, and \_\_\_\_\_ satisfy the second criterion of an inherently permanent structure under § 1.263A-8(c)(3) because they are affixed to real property for an “indefinite” period of time.

In sum, the \_\_\_\_\_, \_\_\_\_\_, and \_\_\_\_\_ qualify as inherently permanent structures under § 1.263A-8(c)(3) because they are affixed to real property and will ordinarily

remain affixed for an indefinite period of time.<sup>2</sup> Because they are “inherently permanent structures under § 1.263A-8(c)(3), the \_\_\_\_\_, \_\_\_\_\_, and \_\_\_\_\_ satisfy the definition “real property” under § 1.199-3(m)(3).

#### Machinery Under Section 1.263A-8(c)(4)

Our conclusion that the \_\_\_\_\_, \_\_\_\_\_, and \_\_\_\_\_ qualify as inherently permanent structures under § 1.263A-8(c)(3) is not impacted by § 1.263A-8(c)(4). Section 1.263A-8(c)(4)(i) provides that a structure that is property “in the nature of machinery” or is “essentially an item of machinery or equipment” is “not an inherently permanent structure” and is “not real property.” We think that this language is intended to clarify that machinery and inherently permanent structures are mutually exclusive categories of property. We do not think that § 1.263A-8(c)(4)(i) imposes an additional test whereby property that otherwise qualifies as an inherently permanent structure under § 1.263A-8(c)(3) must also not be machinery under § 1.263A-8(c)(4).<sup>3</sup>

Section 1.263A-8(c)(4)(i) provides an additional clarification that where a building or inherently permanent structure includes property in the nature of machinery as a structural component thereof, “the property in the nature of machinery is real property.” This statement is consistent with § 1.263A-8(c)(1), which provides that real property includes “the structural components of both buildings and inherently permanent structures, such as walls, partitions, doors, wiring, plumbing, central air conditioning and heating systems, pipes and ducts, elevators and escalators, and other similar property.”

Finally, § 1.263A-8(c)(4)(ii) clarifies that “a structure may be an inherently permanent structure, and not property in the nature of machinery or essentially an item of machinery, even if the structure is necessary to operate or use, supports, or is otherwise associated with, machinery.” This statement serves merely to confirm that where a structure is necessary to operate or use, supports, or is otherwise associated with, machinery (presumably, machinery that is not a structural component of the structure), the structure is an inherently permanent structure, separate from the associated machinery.

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<sup>2</sup> Section 1.263A-8(c)(3) describes an additional category of property that qualifies as inherently permanent structures, namely 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). Having already determined that the \_\_\_\_\_, \_\_\_\_\_, and \_\_\_\_\_ satisfy § 1.263A-8(c)(3) under the affixed for an indefinite period of time standard, we do not need to determine whether these units also constitute other tangible property under the principles of former § 48(a)(1)(B) and § 1.48-1(d).

<sup>3</sup> Note that the analysis under CCA 201211011 (Mar. 16, 2012) suggests an overlap between inherently permanent structures and machinery whereby property that qualifies as an inherently permanent structure under § 1.263A-8(c)(3) must also not be machinery under § 1.263A-8(c)(4). We agree with the conclusions of CCA 201211011, namely that the jacket-type platforms are the type of inherently permanent structures described in § 1.263A-8(c)(4)(ii); however, we disagree with the portion of the analysis that concerns the relationship between §§ 1.263A-8(c)(3) and 1.263A-8(c)(4).

Our reading of the relationship between § 1.263A-8(c)(3) and § 1.263A-8(c)(4) as clarifying the mutually exclusive nature of machinery and inherently permanent structures is consistent with the Preamble to the final regulations, T.D. 8584 (Dec. 29, 1994), which supports a broad reading of “real property” for purposes of § 263A(f), consistent with the intent of § 263A to ensure that taxpayers capitalize the appropriate amount of production costs, including the production of real property.<sup>4</sup> This reading is also consistent with the fact that several examples of inherently permanent structures provided in § 1.263A-8(c)(3), including power generation and transmission facilities and derricks, have a mechanical function. It would not be reasonable to include such items as examples of inherently permanent structures under § 1.263A-8(c)(4) only to remove them from such classification by recasting them as machinery under § 1.263A-8(c)(4).

Therefore, § 1.263A-8(c)(4) does not alter our foregoing conclusion that the \_\_\_\_\_, \_\_\_\_\_, and \_\_\_\_\_ satisfy the definition of inherently permanent structures under § 1.263A-8(c)(3), and are “real property” for purposes of § 1.199-3(m)(3). Based on this conclusion, Taxpayer’s activities in projects in the United States that involve substantial renovation, construction, or erection of \_\_\_\_\_, \_\_\_\_\_, and \_\_\_\_\_ qualify as real property construction activities and gross receipts from such projects are DPGR under § 1.199-3(m). Taxpayer, therefore, may be entitled to the deduction under § 199, assuming all of the other § 199 requirements are met.

#### CAVEATS:

A copy of this technical advice memorandum is to be given to the taxpayer. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

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<sup>4</sup> See T.D. 8584, 1995-1 C.B. 20, 22 (Dec. 29, 1994). Although not binding, the conclusion that machinery and inherently permanent structures are separate and distinct categories of property is also consistent with the text of the proposed regulations. Prop. Treas. Reg. § 1.263A(f)-1(c)(3) (Aug. 9, 1991) contained the same general definition of inherently permanent structures as the final regulations (i.e., affixed to real property for an indefinite period of time); however, the regulation addressed machinery only in the context of “other tangible property” under § 48, stating that “[a]ny 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) (and that is not property in the nature of machinery under § 1.48-1(c)) is treated for purposes of this section as an inherently permanent structure.” Property that was “other tangible property under the principles of former section 48(a)(1)(B) and § 1.48-1(d)” did not overlap with “property in the nature of machinery under § 1.48-1(c),” and so this statement serves merely to differentiate between two categories of property – not to suggest that property in the nature of machinery under § 1.48-1(c) was excepted from the category of “other tangible property under the principles of former section 48(a)(1)(B) and § 1.48-1(d). Thus, under both the proposed and final regulations, the reference to machinery serves merely to contrast machinery with another category of property.