

IRS Provides Safe Harbor for Depreciation of Rotable Spare Parts

In Rev. Proc. 2007-48, IRB 2007-29, 1, the IRS provided a safe harbor method of accounting to treat rotatable spare parts as depreciable assets, rather than as inventory, in accordance with Rev. Rul. 2003-37, 2003-1 CB 717, effective for tax years ending on or after December 31, 2006. Taxpayers can obtain automatic consent to adopt the new safe harbor if they account for their rotatable spare parts in accordance with specific provisions in Rev. Proc. 2007-48. Changing treatment of rotatable spare parts is a change in method of accounting subject to the rules of Code Sec. 446 and Code Sec. 481. If a taxpayer is not eligible for an automatic change to the safe harbor method of accounting, the taxpayer may request to change its method of accounting for treating rotatable spare parts by filing a Form 3115, *Application for Change in Accounting Method*.

In order to take advantage of the safe harbor provided in Rev. Proc. 2007-48 taxpayers must:

- repair customer-owned (or customer-leased) equipment under warranty or mainte-

nance agreements that are provided to the customer for either no charge or a predetermined fee that does not change during the term of the agreement (regardless of the taxpayer's costs to comply with the agreement);

- be obligated under the warranty or maintenance agreements to repair the customer's equipment (including all parts and labor related to the repair) for either no charge or a nominal service fee that is unrelated to the actual cost of parts and labor provided;
- maintain a pool or pools of spare parts that are used primarily in the taxpayer's maintenance operation of repairing customer-owned (or customer-leased) equipment under warranty or maintenance agreements, exchange the spare parts for defective parts in the customer-owned (or customer-leased) equipment, and generally repair and reuse the defective parts in its pool of spare parts (the "rotatable spare parts");
- have a depreciable interest in the rotatable spare parts and

have placed such parts in service after 1986; and

- have gross sales (less returns) of rotatable spare parts from the taxpayer's maintenance operation that do not exceed 10 percent of the taxpayer's total gross revenues (less returns) from its maintenance operation for the tax year.

Description of Safe Harbor Method of Accounting

A taxpayer relying on the safe harbor method of accounting for rotatable spare parts as provided in Rev. Proc. 2007-48 must:

- capitalize the cost of the rotatable spare parts under Code Sec. 263 and depreciate these parts under Code Sec. 168;
- establish one or more pools for the rotatable spare parts;
- identify the disposed rotatable spare parts; and
- determine the depreciable basis of the rotatable spare parts for depreciation purposes.

If taxpayers follow the safe harbor provided in Rev. Proc. 2007-48, the IRS will not challenge the taxpayer's treatment of the pools of rotatable spare parts as depreciable assets. ■