



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

OFFICE OF
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INTERNAL REVENUE SERVICE NATIONAL OFFICE FIELD SERVICE ADVICE

MEMORANDUM FOR ALL AREA COUNSEL (LARGE AND MID-SIZE BUSINESS)
AND AREA COUNSEL (SMALL BUSINESS/SELF
EMPLOYED)

FROM: Linda Burke
Division Counsel (Large and Mid-Size Business) CC:LM

SUBJECT: Airframe Heavy Maintenance Visit

This is to alert all Area Counsel about the attached guidance for examiners issued June 8, 2001, by the Industry Director, Heavy Manufacturing and Transportation regarding the proper tax treatment of cyclical heavy maintenance visits on aircraft airframes.

Please contact Dave Lumbreras, Air Transportation Technical Advisor, LMSB:PFTG:Gr2, at (972) 308-1569 or Dave.C.Lumbreras@irs.gov, or Hugh Whitledge, Associate Technical Advisor, LM:PFTG:TA:Team 2, at (972) 308-7016 or Hugh.D.Whitledge@irs.gov, if you have any further questions.

Attachment
As stated

**DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224
June 8, 2001**

**Large and Mid-Size
Business Division**

**MEMORANDUM FOR DIRECTORS, FIELD OPERATIONS, HEAVY MFG., &
TRANSPORTATION
DIRECTOR, FIELD SPECIALISTS
DIRECTOR, PREFILING AND TECHNICAL GUIDANCE**

**FROM: Thomas J. Smith
Industry Director, Heavy Manufacturing and Transportation**

**SUBJECT: Field Guidance on the Planning and Examination of the
Heavy Maintenance Visit (HMV) on Airframes**

The purpose of this memo is to provide guidance to examiners in the audit of the Airframe Heavy Maintenance Visit issue in light of the publication of Revenue Ruling 2001-04. This is not intended to be a technical position but to provide audit issue direction to effectively utilize our resources.

Revenue Ruling 2001-04 (2000 TNT 247) published December 22, 2000, provides guidance as to the proper tax treatment of cyclical HMV on an aircraft's airframe. The Ruling presents three factual situations numbered 1, 2, and 3. Following an analysis of the applicable legal authorities, the ruling concludes that the costs incurred to perform an HMV generally are deductible as ordinary and necessary business expenses under section 162. However, the costs incurred in conjunction with an HMV must be capitalized to the extent they materially add to the value of, substantially prolong the useful life of, or adapt the airframe to a new or different use. With reference to the three situations presented in the ruling, situation 1 is concluded to be entirely a deductible expense; situation 2 is concluded to have four specific items requiring capitalization; and situation 3 is concluded to be subject to the so-called "plan of rehabilitation" doctrine and, thus, entirely capital.

Some of the terminology used in the ruling (i.e. "significant portion", "substantial structural part", "major component", or "material upgrade or addition") is undefined. Pending clarification of these terms, this document is intended to provide guidance to examiners on the efficient use of time and resources in the examination of this issue. Based on the ruling, the commitment of staffing to examine airframes, which underwent the first or second HMV, is usually not an

effective utilization of those resources. The type of steps that should be taken in planning and conducting an examination of the airframe issue are shown below.

Planning

At the beginning of an examination, you should contact the Air Transportation Technical Advisor group and obtain a listing of the taxpayer's fleet composition. This will show you the type and age of all the aircraft (i.e. Boeing 727, Boeing 737, DC-10, Airbus A320). This list can be shared with the taxpayer and used to confirm the type and age of their fleet. From this, you will quickly see if the taxpayer has an aging fleet that would be subject to a third HMV or a newer one that would not be subject to it. If they have few aircraft subject to a third HMV, you should not spend significant resources on this issue.

What do you do if the taxpayer has numerous planes that could be subject to a third HMV?

1. Request a list identifying, by tail number if possible, each aircraft in the taxpayer's fleet that underwent a third or later airframe HMV during the years under examination. The amount spent on each aircraft should be requested along with a breakdown of the individual items making up the amounts capitalized and expensed. From the perspective of the IRS, the preferred method of identifying an aircraft/airframe is by its "tail number". You should request that where possible the tail number be used to identify aircraft. As the "tail number" is commonly used by taxpayers to identify their aircraft, this should generally not be a problem. In the event the tail number cannot be provided, the taxpayer will use an alternate identifier. In this case, reconciliation between the tail number and the alternate identifier should be requested. If there are few or no third or later HMV's, the costs involved are in line with the cost of a situation 1 or 2 HMV; the Team Manager should consider eliminating this area from the audit plan.
2. If the audit of the HMV is necessary, contact the Air Transport Technical Advisor for his/her support and assistance. The effective examination of the HMV issue requires an understanding of the taxpayer's accounting and maintenance practices. If you have not already done so, request the taxpayer provide a copy of its capitalization policy with regard to aircraft modifications and/or upgrades.
3. If you have not held a meeting with the taxpayer's employees who are responsible for airframe HMV, do so. The purpose of this meeting is to develop an understanding of the taxpayer's maintenance practices, how maintenance is accounted for, and the terminology used within the company to describe it.

Based on the data collected, the Team Manager should determine the extent of resources to devote to this issue. Conversations with the taxpayer and the Air Transport team may assist you in setting the scope and depth and help minimize audit burden on both the taxpayer and the audit team.

Conduct of the Examination

1. By now, the Team Manager should have secured needed engineering support and determined which airframes to examine. The focus of the sample should be on aircraft where the HMV is likely to have a capital component (i.e. fall within the ruling's situation 3, aircraft converted to another use, costs exceeding the norm, or used aircraft purchased and rehabilitated).
2. Following the selection of an HMV to examine, and if you have not already done so, request a tour of the taxpayer's maintenance facility. The purpose of this tour is for you to further develop your understanding of the taxpayer's maintenance practices. If the taxpayer uses an outside third party to perform its maintenance, the time of the visit should ideally be set to take place when one of the taxpayer's aircraft is undergoing an HMV.
3. Request the information the taxpayer relied on in determining the useful life of its aircraft. Such information could include, but is not limited to, information on acquisition dates, age at time of acquisition, maintenance status when acquired, historic data on how long aircraft are retained, and current age of the taxpayer's fleet. The taxpayer's records should be regarded as the preferred source of this information since they reflect the taxpayer's unique operating environment. This data should be compared to that secured from the Air Transport team to identify any significant variances needing reconciliation.
4. Request a complete copy of the taxpayer's maintenance plan (may also be called a maintenance manual or a maintenance planning document) as filed with the FAA for the years under examination for each fleet type in the sample. A maintenance plan is a "living document" and changes with time so it is important that you have documents that reflect the work that was actually done on the airframe. If the taxpayer has only the current document, you should work with the taxpayer on a reconstruction. It may be that a reconstruction is unnecessary because the taxpayer believes that the current document does not differ in any significant regard from the document in use during the years under audit. If this is so, the execution of a document to this effect is suggested to prevent any misunderstandings in the future.
5. Request the applicable "workscope" or "statement of work" documents for each aircraft in the sample. If the same workscope was used for several of the

aircraft in the sample, only one set of the documents needs to be supplied, provided the taxpayer identifies all aircraft to which the documents apply.

6. If the taxpayer uses a third party maintenance vendor to perform work on any of the sample aircraft, request a complete copy of the taxpayer's contract with the vendor along with copies of the invoices for each sample aircraft. If the taxpayer performs its HMV in-house, request relevant maintenance records. The relevant records should have been identified from the meetings with the taxpayer's maintenance personnel described previously.
7. Evaluate the information you have gathered and compare it to the guidance contained in the Ruling in regard to situation 3. In addition some of the specific additions to aircraft as highlighted in situation 2 of the Ruling in the form of the fire protection, air phone, and ground proximity warning systems should be considered for capitalization. I recognize the list is not all comprehensive and hope to have added guidance of the type of specific items, which could also be considered standing alone, for capitalization.

If you have any questions, please contact me at (732) 452-8102 or either Dave Lumbreras, Air Transportation Technical Advisor, at (972) 308-1569 or Hugh Whitley, Associate Technical Advisor, at (972) 308-7016.

cc: Commissioner and Deputy Commissioner, LMSB
Director, Quality Assurance and Performance Management
LMSB Industry Directors