

Client Alert

June 2011

IRS Declines Appeal of Street Light Issue in PPL Case: Assets Fall into Residual Class for Depreciation Unless Specifically Included in Another Asset Class

On July 28, 2010, in *PPL Corporation & Subsidiaries v. Commissioner of Internal Revenue*, 135 T.C. No. 8, the United States Tax Court held that street light assets owned and depreciated by an electric utility do not constitute assets used in the distribution of electricity for sale (20-year recovery period). Rather, the Tax Court found that street light assets are used to provide light for public safety and are classified in the residual class for assets with “no class life” (7-year recovery period).

On January 5, 2011, the IRS filed a notice of appeal of the *PPL* decision to the U.S. Court of Appeals for the Third Circuit. On May 5, 2011, the Government’s opening brief in the *PPL* appeal officially declined an appeal of the street lighting depreciation issue, confirming that it “is not at issue in this appeal.” See *PPL Corp. & Subs. v. Commissioner of Internal Revenue*, Third Circuit Court of Appeals Case No. 11-1069. The Government similarly declined an appeal in its opening brief filed in a related case involving Entergy Corporation in the Court of Appeals for the Fifth Circuit. See *Entergy Corp. & Affiliated Subs. v. Commissioner of Internal Revenue*, No. 10-60988 (5th Cir., Apr. 13, 2011).

The Tax Court holding in *PPL* is the first court opinion to address the application of the residual class under Section 168(e)(3) of the Internal Revenue Code. The opinion limits the so-called “activity classes” described in Revenue Procedure 87-56, 1987-2 C.B. 674, to the specific activities described in each class. The opinion rejects the IRS’ notion that the activity classes are broader than the specific activities described in those activity classes and encompass *all* the assets of a particular industry (e.g., the electric utility industry). Rather, the Tax Court’s opinion in *PPL*, for the first time, recognizes the expansive, catchall nature of the residual class, even for assets held by the traditional industries identified in the Revenue Procedure.

This holding has a significant impact on federal income tax depreciation, not only for the electric utility industry but also for all industries. Taxpayers may want to review the assets included within any classification to determine if those assets are specifically referenced within the “activity classes” described in Revenue Procedure 87-56 or should be included in the residual class.

Richard May, Mark Bierbower, and Tim Jacobs of the Tax Controversy Practice at Hunton & Williams LLP handled the Tax Court litigation and are presently handling the Third Circuit appeal of another issue in the *PPL* case. Please contact us regarding the potential impact of the *PPL* opinion on depreciation of various assets or for other tax controversy or litigation matters.

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