

Office of Chief Counsel
Internal Revenue Service
Memorandum

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date: November 10, 2004

to: Bruce Dickinson, PSP
Territory Manager, SB/SE
Compliance Area 5
Jacksonville, FL

from: Robert M. Brown
Associate Chief Counsel
(Income Tax & Accounting)

subject:

LEGEND

X =

Commodities =
Property =

FACTS

X manufactures and installs Commodities. X manufactures certain acoustical, seating, ceiling and other materials that are to be incorporated into the finished product. X purchases raw materials, e.g., lumber, fabric, and similar items and produces elements of its finished products that are installed in a customer's Property as a Commodity.

X requested permission to change its accounting method of recognizing income and expenses for what it termed the construction portion of its hybrid contracts from an accrual method to the completed contract method, for the taxable year beginning

. This office denied the taxpayer request for permission to make the requested change in accounting method.

However, the taxpayer indicates that its overall method of accounting is the accrual method and such method is being used to report income and expenses from what appear to be manufacturing activities.

LAW AND ANALYSIS

Section 460(a) of the Internal Revenue Code provides, in part, that in the case of any long-term contract, the taxable income from such contract shall be determined under the percentage of completion method (as described in § 460(b)).

Section 1.460-2(a) of the Income Tax Regulations provides that § 460 generally requires a taxpayer to determine income from a long-term manufacturing contract using the percentage-of-completion method (PCM). A contract not completed in the contracting year is a long-term manufacturing contract if it involves the manufacture of personal property that is (1) a unique item of a type that is not normally carried in the finished goods inventory of the taxpayer; or (2) an item that normally requires more than 12 calendar months to complete. See *also* § 460(f).

It appears that one of the products that X manufactures are components for Commodities that are specifically designed to the specifications of a particular customer. Thus, it appears that X may enter into long-term manufacturing contracts under § 1.460-2. If so, X would be required to report these contracts under the PCM rather an overall accrual method of accounting.

We refer this matter to you for any action you believe is appropriate.

This writing may contain privileged information. Any unauthorized disclosure of this writing may undermine our ability to protect the privileged information. If disclosure is determined to be necessary, please contact this office for our views.

Please call (202) 622-4920 if you have any further questions.

Attachments

Copy of ruling letter

Copy of administrative file