

Client Alert

June 2018

IRS Announces Campaign Focused on Interest Capitalization for Self-Constructed Assets

On May 21, 2018, the Internal Revenue Service (“IRS”) announced the identification and selection of six Large Business & International division (“LB&I”) compliance campaigns. The six campaigns were identified through LB&I data analysis and suggestions from IRS employees.

Included in the announced campaigns is a compliance initiative focused on interest capitalization for self-constructed assets. Pursuant to section 263A of the Internal Revenue Code, a taxpayer must capitalize interest expenses paid or incurred upon engaging in certain production activities. Production activities include the construction of facilities and individual units of property. Pursuant to section 263A(f), a taxpayer must capitalize interest that a taxpayer pays or incurs during the production of “designated property.” Section 263A(f) defines “designated property” as any real property or tangible personal property that has either: (i) a depreciable class life of 20 years or more, (ii) an estimated production period exceeding two years, or (iii) an estimated production period exceeding one year and an estimated cost exceeding \$1 million.

LB&I’s stated goal in this compliance campaign is “to ensure taxpayer compliance by verifying that interest is properly capitalized for designated property and the computation to capitalize that interest is accurate.” LB&I intends to meet its goal by providing issue-based examinations, education soft letters, and educating taxpayers and practitioners to encourage voluntary compliance. It is unclear exactly what prompted IRS to focus on interest capitalization and, more specifically, self-constructed assets. However, the IRS’s campaign could have a far-reaching impact.

Our tax controversy team has substantial experience in addressing interest capitalization (and interest during construction) issues including recent audit, regulatory, and litigation experience. If you have any questions regarding interest capitalization of self-constructed assets or LB&I’s compliance campaign, please contact:

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