

IRC Section 266

Election To Capitalize Carrying Charges

Overview

Generally, taxpayers are permitted a deduction for amounts paid or accrued for taxes, interest and other carrying charges. However, §266 provides taxpayers with the option of capitalizing costs that would otherwise be deductible. Reg. §1.266-1(b)(1) outlines the following categories of costs which at the taxpayers election are chargeable to capital accounts either as a component of original cost or other basis:

- i. Costs related to unimproved and unproductive real property. Costs which may be capitalized are annual taxes, interest on a mortgage, and other carrying charges. Delay rentals, which are payments made by a lessee for the option to defer the commencement of drilling operations under an oil, gas, and mineral lease, may be capitalized as carrying charges under this provision. An election under this provision is effective only for the year for which it is made.
- ii. Costs related to real property, whether improved or unimproved and whether productive or unproductive. Costs which may be capitalized are interest on a loan, payroll taxes paid by the owner of such real property, taxes imposed on the purchase of materials, or on the storage, use or other consumption of materials, and other necessary expenditures. An election under this provision is effective until the development or construction work in that subdivision has been completed.
- iii. Costs related to personal property. Costs which may be capitalized are payroll taxes for transporting machinery or other fixed assets to the plant or installing them, interest on a loan to purchase such property or pay for transporting or installing the same, and taxes paid on the purchase of such property or on the storage, use, or other consumption of such property paid or incurred up to the date of installation or the date when such property is first put into use by the taxpayer, whichever date is later. An election made this provision is effective until the later of either the date of installation of the property described in that subdivision, or the date when such property is first put into use by such taxpayer.
- iv. Costs related to other taxes and carrying charges. Costs which may be capitalized are any other taxes and carrying charges with respect to property,

otherwise deductible, which in the opinion of the Commissioner are, under sound accounting principles, chargeable to a capital account. An election made with respect to other taxes and carrying charges is effective as determined by the Commissioner

If in any taxable year there are two or more items from the above stated categories which relate to the same project, the taxpayer may elect to capitalize any one or more of such items even though he does not elect to capitalize items of the same type relating to other projects. However, if expenditures for several items of the same category (e.g., more than one type of taxes) are incurred with respect to a single project, the election to capitalize must, if exercised, be exercised as to all items of that category.

A taxpayer must closely examine the capitalization of costs required in other Code sections such as §263A before electing to capitalize carrying charges under §266. PLR 9132001 provides an example of where a §266 election was held invalid by the IRS in a technical advice memorandum because the intent of the election was in conflict with capitalization requirements of §263A.

When to File

The election is made by attaching a statement to the tax return for the taxable year in which the election is to be effective. The election must be made no later than the due date, including extensions, of the taxpayer's return for such year.

Where to File

The election statement is attached to taxpayers income tax return filed within the required time periods and mailed to the designated Internal Revenue Service Center.

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1. Code Section: 266
2. Topic: Deduction Items; Depreciation and Amortization; Gain/Loss; Natural Resources
3. Return Type: 1040, 1065, 1120

Authorities

IRC §266; Reg. §1.266-1(b) and (c); Rev. Rul. 55-118; IRS Letter Ruling 9132001