

## Rev. Proc. 98-39

### SECTION 1. PURPOSE

.01 This revenue procedure modifies Rev. Proc. 97-35, 1997-33 I.R.B. 11, which describes three alternative methods of accounting for package design costs: (1) the capitalization method, (2) the design-by-design capitalization and 60-month amortization method, and (3) the pool-of-cost capitalization and 48-month amortization method. A taxpayer with package design costs within the scope of Rev. Proc. 97-35 may change to or adopt any one of these three methods. The procedures for a taxpayer to change to one of these three methods are provided in Rev. Proc. 97-37, 1997-33 I.R.B. 18, which provides simplified and uniform procedures to obtain automatic consent to make this and other changes in methods of accounting.

.02 Rev. Proc. 97-35 is modified to make clear that capitalization under § 263 (and not § 263A) of the Internal Revenue Code is applicable for package design costs incurred in taxable years beginning after December 31, 1993, pursuant to § 1.263A-2(a)(2)(ii) of the Income Tax Regulations. In addition, Rev. Proc. 97-35 is further modified to make clear that it does not apply to the costs of a package design that is an "amortizable § 197 intangible" as defined in § 197(c). Rev. Proc. 97-35 will appear in 1997-2 C.B. as modified by this revenue procedure.

### SECTION 2. MODIFICATIONS

.01 Section 1 of Rev. Proc. 97-35 is modified by deleting section 1.02.

.02 Section 2 of Rev. Proc. 97-35 is modified by adding the word "design" after the word "package" in the next to last sentence.

.03 Section 3.03 of Rev. Proc. 97-35 is modified by changing the regulation cite, deleting the last sentence and a cite, and adding a new last sentence and a cite to read as follows:

See former § 1.263A-1T(a)(5)(iii) of the temporary regulations. Section 263A and the temporary regulations thereunder required that costs incurred after December 31, 1986, in

taxable years beginning before January 1, 1994, must be capitalized to the extent that they were attributable to the development and design of product packages. See Rev. Rul. 89-23.

.04 Sections 3.04 and 3.05 of Rev. Proc. 97-35 are renumbered as sections 3.07 and 3.08, respectively, and new sections 3.04, 3.05, and 3.06 are added to read as follows:

.04 Section 1.263A-2(a)(2)(ii) of the final regulations, which, in the case of property that is not inventory, applies to costs incurred in taxable years beginning after December 31, 1993, modified the definition of tangible personal property to exclude from "other similar property" any intellectual or creative property that is embodied in a tangible medium that is mass distributed merely incident to the distribution of a principal product or good of the creator. Thus, package design costs incurred in taxable years beginning after December 31, 1993, are not treated as costs of tangible personal property under § 263A.

.05 Accordingly, taxpayers are required to: (1) capitalize under § 263 package design costs incurred prior to January 1, 1987, or in taxable years beginning after December 31, 1993; and (2) capitalize under § 263A package design costs incurred after December 31, 1986, in taxable years beginning before January 1, 1994.

.06 Section 197(a), which is generally applicable to property acquired after August 10, 1993, provides that a taxpayer is entitled to an amortization deduction with respect to any "amortizable § 197 intangible" (as defined in § 197(c)), which may include the costs of certain package designs. Section 197(b) provides that, other than the amortization provided in § 197(a), no other depreciation or amortization is allowable for an amortizable § 197 intangible.

.05 Section 3.05 of Rev. Proc. 97-35 (new section 3.08) is modified by inserting in the first sentence after "Thus," the following: "except for the costs of a package design that is an amortizable § 197 intangible,".

.06 Section 4 of Rev. Proc. 97-35 is modified to read as follows:

.01 *Applicability.* Except as provided in section 4.02 of this revenue pro-

cedure, this revenue procedure applies to the costs of a package design as defined in section 2 of this revenue procedure.

.02 *Inapplicability.* This revenue procedure does not apply to the costs of a package design that is an amortizable § 197 intangible as defined in § 197(c).

.07 Sections 5.01(2)(the capitalization method), 5.02(2)(the design-by-design capitalization and 60-month amortization method), and 5.03(2)(the pool-of-cost capitalization and 48-month amortization method) of Rev. Proc. 97-35 are modified to read as follows:

.01(2) *Computation of basis.* The basis of each package design (or modification to the design) subject to capitalization is determined by applying the provisions of § 263 and the regulations thereunder to costs incurred prior to January 1, 1987, or in taxable years beginning after December 31, 1993, and by applying the provisions of § 263A and the regulations thereunder to costs incurred after December 31, 1986, in taxable years beginning before January 1, 1994 (regardless of the tax year the design (or modification to the design) is placed in service). The costs required to be capitalized are described in section 2 of this revenue procedure.

.02(2) *Computation of basis.* Under the design-by-design capitalization and 60-month amortization method, the basis of each package design (or modification of the design) subject to capitalization must be determined by applying the provisions of § 263 and the regulations thereunder to costs incurred prior to January 1, 1987, or in taxable years beginning after December 31, 1993, and by applying the provisions of § 263A and the regulations thereunder to costs incurred after December 31, 1986, in taxable years beginning before January 1, 1994 (regardless of the tax year the design (or modification to the design) is placed in service). The costs required to be capitalized are described in section 2 of this revenue procedure.

.03(2) *Costs subject to capitalization.* All package design costs are subject to capitalization without regard to whether the costs create a package design (or modification to the design) having an ascertainable useful life that extends substantially beyond the end of the tax year in which the costs are incurred. Thus, all package design costs incurred prior to January 1, 1987, or in taxable years be-

ginning after December 31, 1993, that are capitalized under § 263 and the regulations thereunder or that would be capitalized under § 263 and the regulations thereunder but for the fact that the costs create a package design (or modification to the design) having an ascertainable useful life that does not extend substantially beyond the end of the tax year in which the costs are incurred must be capitalized. All package design costs incurred after December 31, 1986, in taxable years beginning before January 1, 1994, that are capitalized under § 263A and the regulations thereunder or that would be capitalized under § 263A and the regulations thereunder but for the fact that the costs create a package design (or modification to the design) having an ascertainable

useful life that does not extend substantially beyond the end of the tax year in which the costs are incurred must be capitalized. The costs required to be capitalized are described in section 2 of this revenue procedure.

.08 Section 5 (CHANGING PACKAGE DESIGN COSTS METHOD) of Rev. Proc. 97-35 is renumbered as new section 6.

.09 Sections 6 (INQUIRIES), 7 (EFFECT ON OTHER DOCUMENTS), and 8 (EFFECTIVE DATE), of Rev. Proc. 97-35 are renumbered as new sections 7, 8, and 9, respectively.

.10 Section 7 (EFFECT ON OTHER DOCUMENTS) of Rev. Proc. 97-35 (new section 8) is modified to read as follows:

Rev. Rul. 89-23, 1989-1 C.B. 85, is

modified. Rev. Proc. 90-63, 1990-2 C.B. 664, is modified, and as modified, is superseded. However, see the transition rules in section 13.02 of Rev. Proc. 97-37.

### SECTION 3. EFFECTIVE DATE

This revenue procedure is effective on August 18, 1997.

### DRAFTING INFORMATION

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