

Part I

Section 162.-- Trade or Business Expenses

26 CFR 1.162-1: Business expenses.
(Also § 263; 1.263(a)-1; 1.162-3.)

Rev. Rul. 98-25

ISSUE

Under the circumstances described below, are the costs incurred to replace underground storage tanks ("USTs") containing waste by-products (including the cost of removing, cleaning, and disposing of the old USTs, and acquiring, installing, and filling the new USTs) deductible by the taxpayer as business expenses under § 162 of the Internal Revenue Code or must they be capitalized under § 263?

FACTS

X, a corporation, employs the accrual method of accounting and uses a calendar year. X operates a manufacturing facility. In the past, X's manufacturing operations had produced waste by-products in the course of its operations. Consistent with the industry-wide practice at that time, X placed this waste in steel USTs ("old USTs") that X buried on its land.

In 1998, X incurred costs to remove its old USTs and replace them with USTs made of a steel-fiberglass-reinforced plastic composite material ("new USTs") that comply with current federal, state, and local environmental laws. X excavated a hole in the ground large enough to gain access to the old USTs. X then drained the waste from the old USTs and placed it in a temporary repository. X then lifted the old USTs out of the hole, cleaned

them, and disposed of them at an appropriate disposal facility. In the same taxable year, X placed the new USTs in the same hole, and transferred the waste from the temporary repository into the new USTs. Finally, X sealed the new USTs and filled the hole with soil.

The new USTs will not be emptied and reused, but will remain filled with the same waste indefinitely. Applicable law requires that X continue to monitor the buried new USTs to detect leaks, if any. Once they are filled with waste and sealed, the new USTs have no salvage value.

LAW AND ANALYSIS

Sections 162 and 1.162-1(a) of the Income Tax Regulations allow a deduction for all the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business.

Section 1.162-3 provides, in part, that taxpayers carrying materials and supplies on hand should include in expenses the charges for materials and supplies only in the amount that they are actually consumed and used in operation during the taxable year for which the return is made.

Sections 263 and 1.263(a)-1(a) provide that no deduction is allowed for any amounts paid out for new buildings or for permanent improvements or betterments made to increase the value of any property. Section 1.263(a)-2(a) provides that capital expenditures include the cost of acquisition, construction, or erection of buildings, machinery and equipment, furniture and

fixtures, and similar property having a useful life substantially beyond the taxable year.

Through provisions such as §§ 162(a), 263(a), and related sections, the Code generally endeavors to match expenses with the revenues of the taxable period to which the expenses are properly attributable, thereby resulting in a more accurate calculation of net income for tax purposes. See, e.g., INDOPCO, Inc. v. Commissioner, 503 U.S. 79, 84 (1992); Commissioner v. Idaho Power Co., 418 U.S. 1, 16 (1974). Moreover, as the Supreme Court specifically recognized, the "decisive distinctions [between capital and ordinary expenditures] are those of degree and not of kind," and a careful examination of the particular facts of each case is required. Welch v. Helvering, 290 U.S. 111, 114 (1933); Deputy v. du Pont, 308 U.S. 488, 496 (1940); see also INDOPCO, 503 U.S. at 87.

The useful life of an asset for § 263 purposes is its useful life to the taxpayer, not its inherent useful life. See Silvertown v. Commissioner, T.C.M. 1977-198; Massey Motors, Inc. v. United States, 364 U.S. 92 (1960). Unlike most storage tanks, which are used to hold a substance temporarily and are emptied and refilled repeatedly throughout their useful lives, X's new USTs are filled with waste once, sealed indefinitely, and thereafter have no salvage value. Upon being filled with waste and sealed, the new USTs have no remaining useful life to X. X's new USTs are used merely to facilitate the disposal of waste and therefore are similar to a material or supply that is consumed

and used in operation during the taxable year. Accordingly, because X acquired, filled, and sealed the new USTs all in 1998, the costs of acquiring and installing the new USTs are not capital expenditures, but are ordinary and necessary business expenses deductible under § 162. The new USTs, which are used once and then sealed indefinitely, are distinguishable from the groundwater treatment facilities in Rev. Rul. 94-38, 1994-1 C.B. 35, which are used by the taxpayer substantially beyond the taxable year.

Further, X's costs of removing, cleaning, and disposing of the old USTs, and filling and on-going monitoring of the new USTs are deductible as business expenses under § 162.

The results would be the same if X had instead ceased to operate the manufacturing facility in 1998 or in a previous taxable year. The results would also be the same if X had instead used storage tanks that were designed to store waste above ground.

HOLDING:

Under the circumstances described above, the costs incurred to replace USTs containing waste by-products (including the cost of removing, cleaning, and disposing of the old USTs, and acquiring, installing, and filling the new USTs) are deductible by the taxpayer as ordinary and necessary business expenses under § 162.

EFFECT ON OTHER DOCUMENTS

Rev. Rul. 94-38 is distinguished.

DRAFTING INFORMATION

For further information contact Merrill Feldstein of the
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