6 T.C. 950 (1946)

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When a lessee makes improvements to leased property that are integral to the operation of specific machinery and the lease term is indefinite due to likely renewals, the depreciation of the improvement costs should be based on the useful life of the machinery, not the original lease term.

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Summary

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Standard Tube Co. installed a seamless tube mill and auxiliary equipment in a building leased from Ford Motor Co. The company capitalized the costs of installing the equipment, including foundations, on its books. The lease was repeatedly renewed annually. The Tax Court addressed whether the installation costs should be amortized over the initial lease term or depreciated over the useful life of the machinery. The court held that because the lease was indefinitely renewable and the improvements were integral to the machinery, depreciation should be based on the machinery's useful life. This decision acknowledges the economic reality that such improvements are tied to the assets they support, not merely the real estate.

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Facts

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Standard Tube Co. leased buildings and land from Ford Motor Co. starting in 1928. In 1936 and 1937, the company spent $97,916.02 installing a seamless tube mill and auxiliary equipment, including foundations, and capitalized these costs. During the same period, the company spent $18,960.25 on foundations and installation for other machinery, also capitalized. A written lease was executed on September 10, 1936, expiring December 31, 1938, but was renewed annually with modifications to the occupied area.

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Procedural History

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The Commissioner of Internal Revenue determined deficiencies in Standard Tube Co.’s income and excess profits taxes for 1941. The Commissioner disallowed depreciation deductions claimed by Standard Tube Co. relating to the installation costs. The Tax Court reviewed the Commissioner’s determination, focusing on the appropriate method for depreciating the capitalized installation costs.

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Issue(s)

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Whether the costs of installing machinery and equipment, including foundations, in a leased building should be (1) amortized over the term of the initial lease, or (2) depreciated over the useful life of the machinery when the lease is repeatedly renewed, creating an indefinite tenancy and the improvements are integral to the machinery.

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Holding

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No, because Standard Tube Co.’s tenancy was for an indefinite period due to the repeated lease renewals, and the expenditures were specifically related to and thus attached to the machines themselves; therefore, the depreciation should be based on the useful life of the machinery.

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Court’s Reasoning

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The Tax Court reasoned that the critical factor was the indefinite nature of the tenancy. The original lease contained provisions for renewal, and the company had, in fact, renewed the lease annually. The court emphasized that the sale of the seamless tube mill in 1939, after the initial lease expiration, demonstrated an intent to continue the tenancy beyond the original term. The court cited *Rankin v. Commissioner, 60 Fed. (2d) 76*, and other cases supporting the principle that when a lease is for an indefinite period, the exhaustion of improvement costs should align

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with the life of the improvements. The court determined that the foundations were

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