Oxford Paper Co. v. Commissioner, 6 T.C. 614 (1946)

When a party receives cash and property as an inducement to assume the obligations of a lease, the fair market value of the property is taxable income to the recipient and establishes the basis for depreciation of that property.

Summary

Oxford Paper Co. received cash and property, including the Island Division Plant, from Continental Paper & Bag Corporation as an inducement to assume Continental's lease obligations for water rights. The Tax Court addressed whether Oxford Paper Co. could claim depreciation on the Island Division Plant based on its fair market value at the time of receipt. The court held that because Oxford Paper Co. properly reported the fair market value of the plant as income in the year of receipt, it was entitled to depreciate the plant using that value as its basis. The court reasoned that the transaction was akin to a lessor receiving consideration for cancellation of a lease, which is treated as income.

Facts

Continental Paper & Bag Corporation leased the right to draw water from a canal. Continental was obligated to pay annual rental fees, secured by a lien on its Island Division Plant. Continental went bankrupt and sought to be relieved of its lease obligations. Oxford Paper Co. agreed to assume Continental's lease obligations in exchange for $100,000 in cash, 60 shares of stock, and the Island Division Plant. Oxford Paper Co. reported $456,000 as gross income, including $350,000 for the value of the Island Division Plant. Oxford Paper Co. then sought to depreciate the value of the Island Division Plant.

Procedural History

The Commissioner of Internal Revenue determined deficiencies in Oxford Paper Co.'s tax returns, disallowing the depreciation deduction for the Island Division Plant. The Tax Court reviewed the Commissioner's determination.

Issue(s)

Whether Oxford Paper Co., having reported the fair market value of the Island Division Plant as income in the year of receipt, could use that value as the basis for depreciation in subsequent tax years.

Holding

Yes, because the transfer of the Island Division Plant should be treated as income, similar to a payment received for the cancellation of a lease; therefore, Oxford Paper Co. can depreciate the asset using its fair market value at the time of receipt as its basis.

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Court’s Reasoning

The court reasoned that Continental effectively paid Oxford Paper Co. to take over its lease obligations. The court equated the transaction to a lessee paying a lessor to cancel a lease, where the payment is treated as income to the lessor. Quoting *Walter M. Hort, 39 B. T. A. 922*, the court indicated the cash and fair market value of property given to be released from a lease is income to the lessor. The court rejected the Commissioner’s argument that the transaction should be treated as a purchase, which would not give rise to immediate income or a depreciable basis. The Tax Court emphasized that Continental was willing to provide a

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