

## ***Standard Linen Service, Inc., 33 T.C. 852 (1960)***

Costs incurred in reconstructing an inefficient facility to make it operational are considered capital expenditures, not deductible abandonment losses, when the facility is ultimately completed and used for its intended purpose.

### **Summary**

Standard Linen Service, Inc. (the “Petitioner”) built a hydrogen-producing facility for its ore-reducing plant but had to reconstruct it due to inefficiencies. The Petitioner sought to deduct the costs of piping and fittings removed during reconstruction as an abandonment loss. The Tax Court ruled that these costs were part of the overall capital expenditure for the completed facility and not deductible as an abandonment loss, as the facility, while modified, was not abandoned, and the construction was ultimately successful. The court relied on the fact that the facility ultimately served its intended purpose despite initial design flaws requiring corrective actions, which were considered part of the overall construction costs.

### **Facts**

The Petitioner, a tungsten concentrate producer, decided to manufacture hydrogen gas for its reduction furnaces. Construction of the hydrogen-producing facility began in July 1952. However, after completion in October 1952, the facility proved inefficient. The Petitioner then made significant changes to correct design errors, including relocating equipment, adding new components, and removing and discarding some piping and fittings. The facility was finally completed and operational by December 1952. The Petitioner sought to deduct the costs of discarded piping, fittings, and related labor as an abandonment loss.

### **Procedural History**

The Petitioner initially claimed certain expenditures as deductible expenses in its 1952 tax return, but the Commissioner disallowed the deduction. The Petitioner then amended its claim, asserting an abandonment loss. The case went to the United States Tax Court, which ruled in favor of the Commissioner.

### **Issue(s)**

1. Whether costs incurred for labor and materials related to piping and fittings that were discarded during the reconstruction of the hydrogen-producing facility could be deducted as an abandonment loss under Section 23(f) of the 1939 Code.

### **Holding**

1. No, because the costs were part of the overall capital cost of the facility as ultimately completed.

## **Court's Reasoning**

The court reasoned that the facility was not abandoned; instead, the reconstruction was a remedial action to correct design flaws. The court differentiated the case from Dresser Manufacturing Co., where an entirely new engine was developed, scrapped, and a second engine was developed, which the court deemed to be abandonment. In Standard Linen Service, the facility was not a failed experimental project but a working facility that needed adjustments. The court cited *Driscoll v. Commissioner*, where costs associated with correcting design flaws were considered part of the cost of construction. The court determined that the changes, even significant ones, did not represent the abandonment of one facility for a new one but rather the refinement of an existing one to achieve its intended function. The court noted that the Petitioner continued to use the facility after reconstruction, and the majority of the original equipment remained in service.

## **Practical Implications**

This case establishes a clear distinction between true abandonment losses and costs incurred to improve or correct existing capital assets. When a facility is ultimately completed and fulfills its intended purpose, even if initial design flaws require modifications, the costs of such modifications are typically capitalized rather than deducted as losses. This principle is crucial for businesses in determining how to treat costs incurred during construction or improvement projects and highlights the importance of proper record keeping to distinguish between capitalizable costs and deductible expenses.