New England Tank Industries of New Hampshire, Inc. v. Commissioner, 50 T. C. 771 (1968)

Advance payments under government contracts are taxable income in the year received, not deferrable, and depreciation of assets must be based on their useful life to the taxpayer, not the contract term.

Summary

New England Tank Industries contracted with the U. S. Government to provide oil storage facilities and services. Due to financing issues, the contract was revised to increase payments in the first year. The company argued these payments should be treated as loans, advance receipts, or returns of capital. The Tax Court held that these payments were fully taxable income in the year received, not deferrable, as they were not loans or capital returns. Additionally, the court determined that the facilities should be depreciated over 20 years, their useful life, not the 5-year contract term. This case underscores the principles that advance payments are taxable income and that depreciation must reflect the asset's useful life to the taxpayer.

Facts

New England Tank Industries (NET) contracted with the Military Petroleum Supply Agency to provide oil storage facilities and services at Pease Air Force Base. The original contract had a 5-year term with fixed annual payments and options for the Government to renew, purchase, or terminate. Due to financing difficulties, the contract was modified to increase payments in the first year to $2 million, with reduced payments in subsequent years. NET assigned the contract to New England Tank Industries of New Hampshire, Inc. , which secured a $2 million loan from a bank using the contract payments as collateral. The company received payments totaling $2,490,847. 21 over three fiscal years, treating portions as income, return of capital, and advance receipts.

Procedural History

The Commissioner of Internal Revenue determined deficiencies in the company's income tax returns for 1960, 1961, and 1962. The company petitioned the U. S. Tax Court, which heard the case and issued its decision on August 26, 1968.

Issue(s)

1. Whether the $2 million paid to the company in the first year of the revised contract should be treated as a loan, advance receipt, or return of capital, and thus not taxable income in that year?
2. Whether the company can depreciate the oil storage facilities over the 5-year contract term rather than their 20-year useful life?

Holding

1. No, because the payments were not loans or returns of capital but were fully taxable income in the year received.
2. No, because the facilities must be depreciated over their 20-year useful life, not the 5-year contract term.

Court's Reasoning

The court rejected the company's arguments that the increased first-year payments were loans, advance receipts, or returns of capital. It emphasized that the payments were for the use of facilities and services, not loans, and were taxable income in the year received. The court cited *United States v. Williams* and other cases to support this conclusion. Regarding depreciation, the court noted that the facilities had a stipulated 20-year useful life and that the company failed to prove that its use of the facilities would be shorter. The court rejected the argument that Congress intended amortization over the contract term, stating that depreciation must reflect the asset's useful life to the taxpayer.

Practical Implications

This decision impacts how advance payments under government contracts are treated for tax purposes, reinforcing that they are taxable income in the year received unless specific statutory authorization allows deferral. It also clarifies that depreciation periods must reflect the asset's useful life to the taxpayer, not the contract term. This ruling affects how similar government contracts are structured and how businesses plan their tax strategies. Later cases, such as *Gorden Lubricating Co.* , have followed this precedent in similar situations.