Evergreen-Washelli Memorial Park Co. v. Commissioner, 55 T. C. 606 (1970)

Costs of replacing existing cemetery improvements should be added to the improved-land account rather than capitalized and depreciated.

Summary

Evergreen-Washelli Memorial Park Co. , a cemetery operator, deducted costs for replacing an old water pipe system in its cemetery, arguing these were ordinary and necessary expenses. The IRS, however, classified these as capital expenditures, requiring depreciation over 40 years. The Tax Court ruled that replacement costs for cemetery improvements should be added to the improved-land account, to be recovered as lots are sold, aligning with the treatment of initial development costs. This decision clarifies the tax treatment of maintenance and replacement expenditures in the cemetery industry, ensuring consistent accounting practices.

Facts

Evergreen-Washelli Memorial Park Co. , a Washington-based cemetery business, incurred expenses in 1963 and 1964 to replace an aging wooden water pipe system at Evergreen Memorial Park. The company deducted these costs as ordinary business expenses on its tax returns. The IRS challenged this, asserting that the expenditures should be capitalized and depreciated over 40 years. Evergreen-Washelli argued that these costs should either be deductible as operating expenses or added to the improved-land account, to be recovered when cemetery lots were sold.

Procedural History

The IRS issued a deficiency notice to Evergreen-Washelli, disallowing the deductions for the water pipe replacement costs and requiring capitalization and depreciation. Evergreen-Washelli appealed this determination to the U. S. Tax Court, which heard the case and issued its opinion in 1970.

Issue(s)

1. Whether the costs of replacing an existing water pipe system in a cemetery should be deducted as ordinary and necessary business expenses under section 162 of the Internal Revenue Code.
2. Whether, if not deductible, these replacement costs should be added to the improved-land account or capitalized and depreciated under section 263.

Holding

1. No, because the costs of replacing existing improvements are not ordinary and necessary business expenses but are part of the cemetery’s capital investment.
2. Yes, because the costs should be added to the improved-land account, to be

recovered as cemetery lots are sold, consistent with the treatment of initial development costs.

Court’s Reasoning

The Tax Court reasoned that the costs of replacing existing improvements in a cemetery should be treated similarly to initial development costs. The court rejected the IRS’s argument for capitalization and depreciation, citing established case law like National Memorial Park and Sherwood Memorial Gardens, which support allocating such costs to the improved-land account. The court clarified that adding replacement costs to the improved-land account aligns with the principle of allocating these expenditures over the total number of available burial plots, consistent with Sherwood’s requirement. The court emphasized the need for consistent accounting practices in the cemetery industry, stating, “We see no reason for having one rule for the initial costs of cemetery improvements and another for the costs of replacing these improvements. “

Practical Implications

This decision provides clarity on the tax treatment of replacement costs for cemetery improvements, directing that such costs should be added to the improved-land account rather than capitalized and depreciated. Cemetery operators can now more accurately plan their tax strategies, knowing that replacement expenditures will be recovered as lots are sold, similar to initial development costs. This ruling may influence IRS audits and tax planning in the cemetery industry, ensuring consistent application of tax rules. Future cases involving similar issues will likely cite this decision to support the allocation of replacement costs to the improved-land account. The decision also underscores the importance of adhering to established accounting practices within specific industries when determining tax treatment.

