LTV Aerospace Corp. v. Renegotiation Board, 51 T. C. 369 (1968)

Expenditures for research and development, previously capitalized, can be charged as costs of renegotiable business in the year they are abandoned and charged off against income, if they were allocable to such business.

Summary

LTV Aerospace Corp. challenged the Renegotiation Board's determination of excessive profits from 1952 and 1953 contracts, focusing on the accounting treatment of research and development (R&D) costs and profit-sharing plan contributions. The Tax Court ruled that previously capitalized R&D expenditures for the Buckaroo project, deemed abandoned in 1952, were properly charged as costs against that year's renegotiable business, as they were allocable under the Renegotiation Act. Additionally, contributions to a profit-sharing plan were fully deductible as costs of renegotiable business, as they were based on profits before renegotiation. The court upheld the Board's original excessive profit determinations of $750,000 for 1952 and $3,500,000 for 1953, considering LTV's efficiency and the risks it assumed.

Facts

Temco Aircraft Corp. , later LTV Aerospace Corp. , engaged in R&D for the Buckaroo military training airplane from 1948 to 1952. These costs were capitalized annually as "Deferred Development Costs. " In 1952, believing the project unlikely to generate sufficient sales, Temco's board voted to write off the accumulated costs of $531,299 against that year's earnings. Temco also made contributions to a profit-sharing plan in 1952 and 1953, computed on profits before renegotiation. The Renegotiation Board determined Temco had excessive profits of $750,000 for 1952 and $3,500,000 for 1953, which LTV challenged in court.

Procedural History

The Renegotiation Board issued unilateral orders in 1955 and 1957, determining Temco's excessive profits. LTV Aerospace Corp. , as Temco's successor, filed petitions with the U. S. Tax Court for a de novo determination under section 108 of the Renegotiation Act of 1951. The Board filed amended answers, claiming higher excessive profits. The court addressed preliminary accounting issues before considering the excessive profits question.

Issue(s)

1. Whether amounts expended by Temco in prior years for research and development of the Buckaroo airplane are chargeable to costs of renegotiable business in 1952, the year in which Temco determined the project had no significant market potential?
2. Whether amounts contributed to Temco's qualified profit-sharing plan are

allowable as costs of renegotiable business in 1952 and 1953, to the extent such amounts are based on profits computed without any reduction resulting from renegotiation?

Holding

1. Yes, because the previously capitalized Buckaroo R&D expenditures were properly charged against 1952 renegotiable business as they were allocable thereto and were a proper charge against income for tax purposes in that year.
2. Yes, because the contributions to the profit-sharing plan were allowable as costs of renegotiable business in 1952 and 1953, as they were based on profits before renegotiation and were irrevocable once made.

Court’s Reasoning

The court applied section 103(f) of the Renegotiation Act, which allows costs to be determined according to the contractor’s regularly employed accounting method. Temco’s method of capitalizing R&D costs was deemed proper, and the court found the Buckaroo expenditures were reasonably expected to produce future income at the time of capitalization. The court also noted that the Internal Revenue Service did not challenge the 1952 deduction of the Buckaroo expenses. Regarding the profit-sharing plan, the court found that contributions were deductible under the Internal Revenue Code and thus allowable as costs of renegotiable business. The court rejected the Board’s argument that contributions should be based on profits after renegotiation, citing the plan’s irrevocability and the timing of contributions. The court upheld the Board’s original excessive profit determinations, finding LTV’s efficiency and risks did not warrant a lower finding.

Practical Implications

This decision clarifies that previously capitalized R&D costs can be charged against renegotiable business in the year they are abandoned, provided they are allocable to such business. This ruling affects how defense contractors account for R&D costs and manage their profit-sharing plans under the Renegotiation Act. It also impacts how such costs are treated for tax purposes, allowing for deductions in the year of abandonment. The decision reinforces the importance of the contractor’s accounting method in renegotiation proceedings and highlights the need for contractors to carefully document the allocation of R&D costs to specific projects. Subsequent cases have cited this ruling in determining the propriety of charging off capitalized costs in renegotiation contexts.