Standard Oil Co. v. Commissioner, 77 T. C. 349 (1981)

Costs of constructing offshore drilling platforms may be deductible as intangible drilling and development costs if they are at risk and not ordinarily considered to have salvage value.

Summary

Standard Oil Co. sought to deduct costs incurred in constructing offshore drilling platforms as intangible drilling and development costs (IDC) under IRC Section 263(c). The Tax Court ruled that these costs, which included labor, fuel, and other expenses, were deductible as IDC because they were at risk in the drilling ventures and the platforms themselves were not ordinarily considered to have salvage value. The decision hinged on the interpretation of what constitutes IDC and the application of the salvage value concept. The court also addressed issues related to service station signs and lighting, depreciation methods, and the non-deductibility of the minimum tax on tax-preference items.

Facts

Standard Oil Co. and its subsidiaries constructed nine offshore drilling platforms between 1970 and 1971 in the Gulf of Mexico, the North Sea, and Trinidad waters. These platforms were necessary for drilling wells and preparing them for oil and gas production. The costs in dispute were for labor, fuel, repairs, hauling, supplies, and overhead, which were initially capitalized but later claimed as deductible IDC. The platforms were jacket-type, designed specifically for their locations and typically not considered salvageable after 10-15 years of use. Standard Oil also sought investment tax credits for service station signs and lighting facilities installed during the same period, and attempted to change depreciation methods for these assets.

Procedural History

Standard Oil filed a petition with the U. S. Tax Court after the Commissioner of Internal Revenue disallowed the deduction of the platform construction costs as IDC and denied investment tax credits for service station signs and lighting. The court had previously allowed Standard Oil's motion for summary judgment on similar deductions for expenditures from mobile drilling rigs.

Issue(s)

1. Whether the costs incurred by Standard Oil's subsidiaries for constructing offshore drilling platforms during the fabrication phase are deductible as intangible drilling and development costs under IRC Section 263(c)?
2. Whether Standard Oil's subsidiaries are entitled to investment tax credits under IRC Section 38 for investments in new service station signs and lighting facilities in 1971?
3. Whether the service station signs and lighting facilities are subject to

depreciation under methods not chosen when the items were placed into service?
4. Whether the minimum tax on tax-preference items is deductible as an ordinary and necessary business expense under IRC Section 162?

Holding

1. Yes, because the costs were at risk in the drilling ventures and the platforms were not ordinarily considered to have salvage value, except for the costs of conductor pipe which are not deductible.
2. Yes, the components of the signs and lighting systems are “section 38 property,” except for the concrete foundations and poles embedded in concrete.
3. No, because the change in depreciation method requires the Commissioner’s consent, which was not obtained.
4. No, because the minimum tax on tax-preference items is a Federal income tax and not deductible under IRC Section 275.

Court’s Reasoning

The court analyzed the legal framework of IRC Section 263(c) and the regulations under Section 1. 612-4, which define IDC as costs that do not have salvage value. The court determined that the platforms were not ordinarily considered to have salvage value due to the economic infeasibility of reusing them after their useful life. The costs in question were deemed at risk in the drilling ventures, fitting the definition of IDC. The court rejected the Commissioner’s argument that a change in accounting method was required for the deduction, as Standard Oil was merely correcting a mistake in the application of the law. For the investment tax credit issue, the court applied the criteria from Whiteco Industries, Inc. v. Commissioner to determine that most components of the signs and lights were “tangible personal property” eligible for the credit. The court upheld the Commissioner’s position on depreciation and the minimum tax, citing the need for consent to change depreciation methods and the non-deductibility of federal income taxes under IRC Section 275.

Practical Implications

This decision clarifies that costs of constructing offshore platforms can be treated as IDC if the platforms are not considered salvageable, impacting how oil and gas companies account for such expenditures. It reinforces the importance of the “at risk” concept in determining IDC eligibility. For service station signs and lighting, the ruling provides guidance on what qualifies for investment tax credits, affecting how businesses structure their assets for tax purposes. The court’s stance on depreciation methods without consent and the non-deductibility of the minimum tax remains unchanged, influencing tax planning strategies. Subsequent cases have cited this decision in discussions about IDC and asset classification for tax purposes.