

Determining Basis: the Court of Federal Claims Rules that Economic Performance Must Occur Before Liabilities Are Included in Basis.

Historically, accrual taxpayers recognized expenses for tax purposes when two criteria were met: all of the events necessary to establish liability for the expense had occurred and the amount of the liability could be determined with a reasonable degree of accuracy. In 1984, Congress added a third requirement, directing that “economic performance” occur before the expense can be recognized. See I.R.C. § 461(h). The basic principle is that recognition of the expense will be spread out over the period that the taxpayer is subject to the actual economic impact of the liability, which is illustrated by some basic examples in the Code. If the liability results from someone providing the taxpayer with services or property, then economic performance occurs as the taxpayer receives the services or property. I.R.C. § 461(h)(2)(A). Similarly, if the liability imposes on the taxpayer an obligation to render services or furnish property, the expense is recognized as the taxpayer fulfills that obligation. I.R.C. § 461(h)(2)(B). These principles are developed in detail in the relevant Treasury Regulation, Treas. Reg. 1.461-1, and the Code itself provides special rules that apply to tort liabilities and liabilities for workers’ compensation. I.R.C. § 461(h)(2)(C).

Recently, the Court of Federal Claims addressed the question whether the same standards govern the question whether contingent liabilities assumed by a purchaser of property should be included in determining basis, concluding that the economic performance standard must be met. *Amergen Energy Co. v. United States*, 2013 U.S. Claims LEXIS 1543 (Fed. Cl. October 8, 2013).

The taxpayer had purchased a series of nuclear power plants, paying modest amounts of cash and assuming responsibility for the decommissioning costs that were associated with the plants. *Id.* at *11. The dispute centered on whether the decommissioning costs should be included in basis; the taxpayer did so in calculating depreciation, leading the IRS to disallow the associated deduction and assert that additional taxes were due. *Id.* at *13. The taxpayer’s central argument was that its basis was to be determined under Section 1012 of the Code based upon its cost, and then adjusted in accordance with Section 1016.

The court rejected this argument, noting that the plain language of indicated that it applied “[f]or purposes of this title,” *id.* at *33, and concluding that the economic performance test was applicable to determine when liabilities should be included in basis. *Id.* at *34. The court also found confirmation of its holding in the legislative history, which included language indicating that the economic performance test was applicable for all purposes under the Code. *Id.* at *46-*47.

This appears to be a sensible result as it treats liabilities in a consistent way for determining both operating and capital expenditures. What is a little surprising is that there apparently is very little authority on the subject. The parties were apparently unable to locate any direct precedent. *Id.* at *40.

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