Private Letter Ruling 9315004

Date: December 17, 1992
TR-32-200-92
Taxpayer's Name: ***
Taxpayer's Address: ***
Taxpayer's EIN: ***
Tax Years Involved: ***
Conference Held: ***

NOTE: This Technical Advice Memorandum will be given further consideration in connection with a study project on environmental cleanup costs.

ISSUES

1. Whether the costs of an environmental cleanup of PCB contamination are capital expenditures or are currently deductible under the facts provided below.

2. Whether 1) legal fees with respect to claims against taxpayer by state and federal agencies and private third parties, 2) legal fees with respect to litigation between taxpayer and insurance companies, and 3) oversight and certain other costs, are capital expenditures or are currently deductible.

Facts

Taxpayer operates a *** system through A states. *** units at stations situated *** move the *** through the *** system. From year B to 1972, taxpayer used a synthetic lubricant in some of its *** units that contained PCBs, a chemical that was not then viewed as posing any risks to health or the environment. In 1972, the lubricant manufacturer advised taxpayer that PCBs were *** and that it would no longer sell the lubricant. Between *** and *** taxpayer used non-PCB lubricants, and repeatedly drained and flushed the units in order to reduce the remaining PCB residues. Taxpayer disposed of these *** in EPA-approved sites.

Taxpayer also periodically removed *** from inside the *** that *** as a natural consequence of the routine *** . These *** contained PCB contaminants that had previously entered into *** from the *** units. At least until *** taxpayer *** these contaminated *** in numerous earthen pits and trenches on its property. Taxpayer's method of disposing of the contaminated *** and the quantities and years in which the disposal practices took place, were the subject of various regulatory proceedings.

The Environmental Protection Agency (EPA) is authorized to enforce compliance with environmental regulatory standards under the Comprehensive Environmental Response, Compensation, and Liability Act of 1980 (CERCLA), the Resource Conservation and Recovery Act (RCRA), and the Toxic Substances Control Act (TSCA). In *** the EPA discovered PCBs in the *** of a number of *** companies. It instituted a nationwide program under which the *** companies would test and monitor their *** systems. In

*** the EPA *** taxpayer previously had used earthen pits on its property to *** PCB *** , and *** taxpayer to determine whether and the extent to which soils near the pits were contaminated with PCBs. During *** and *** taxpayer submitted information to the EPA regarding PCB levels at various sites. In P and Q the EPA issued to taxpayer formal statutory requests for additional information regarding site conditions.

In E The EPA filed a *** , alleging that PCBs had been illegally disposed of at sites owned and operated by taxpayer. Taxpayer simultaneously entered into a *** with the EPA. Under the terms of the *** , taxpayer agreed to determine which of its sites had been contaminated in amounts that exceeded the permissible levels, to conduct an environmental cleanup of those sites, and to pay a penalty of $N, the tax treatment of which is not an issue in the request for technical advice.

The *** requires testing at F specific sites. These sites are classified within three categories, depending on the probability of finding contamination. Of the F sites, G sites are *** stations. The other sites consist of *** former *** station sites, station sites without *** facilities and miscellaneous other properties. The *** stations range in size from H acres to I acres. The contamination at each *** station site includes one or more of the following: contaminated pits, drainage trenches, areas surrounding the *** , underground waters, site perimeters (from use of PCB-laden liquids to kill weeds along the borders of taxpayer's property), and additional ground areas that were contaminated from that *** PCB- laden *** into the air.

The *** also requires taxpayer to perform environmental “audits” to examine and evaluate the status of its compliance with the requirements of *** . This includes examinations of taxpayer's equipment and operations at all *** storage *** owned and operated by taxpayer, and at numerous other locations within the system. In addition, taxpayer is required to develop a PCB compliance manual for use by company *** personnel.

In addition, *** filed complaints against taxpayer alleging violations of *** laws. As a result, taxpayer was assessed *** and agreed to perform remedial actions at sites in addition to those required under the EPA *** .

For tax years C, taxpayer treated as current expenses all of the costs associated with the cleanup activities, except the costs of *** equipment and associated *** facilities, and groundwater monitoring wells, which it capitalized. Under the cleanup program, during these tax years and future years taxpayer has incurred or anticipates incurring costs for the following: 1) soil contamination assessment, which involves testing to determine the level and location of PCB contamination at *** station sites and other sites; 2) groundwater contamination assessment; 3) remediation, which involves excavating and transporting PCB-contaminated soils and backfilling; 4) legal fees to defend against charges by the EPA, state agencies and claims of private third parties, to litigate insurance matters, and to *** ; 5) costs of oversight of the cleanup operations; 6) costs of environmental audits and compliance manual required under the *** and 7) research and development expenses for chemical remediation processes that might facilitate the remediation of PCBs.

The cleanup program is anticipated to extend through the *** . The amounts for the tax years at issue are nominal compared to the projected cost of the contaminant removal project because the years at issue are the startup phase of the project. Taxpayer's annual report for year O estimates a cost of $J million for the work required under the *** . This amount does not include costs associated with the cleanup of off-site areas and groundwater contamination. Based on agreements with *** , which include remediation activities beyond those which are required under the *** , the annual report estimates that cleanup costs could increase by more than $K million. The total projected cleanup costs represent approximately D% of the book cost of the entire *** system at the end of *** .

Discussion

Issue 1 -- Environmental cleanup costs

Section 162(a) of the Internal Revenue Code allows a deduction for all the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business. Pursuant to section 161 of the Code, the deductibility of expenses under section 162 is subject to the provisions in section 263. Section 263(a) of the Code provides that no deduction shall be allowed for any amount paid out for permanent improvements or betterments made to increase the value of any property or estate, or for any amounts expended in restoring property. Deductions are exceptions to the norm of capitalization. Indopco, Inc. v. Commissioner, ___ U.S. ___, 112 S. Ct. 1039, 1043 (1992).

An income tax deduction is a matter of legislative grace and the burden of clearly showing a right to a claimed deduction is on the taxpayer. The determination of whether an expense is deductible or must be capitalized is a question of fact. Plainfield-Union Water Co. v. Commissioner, 39 T.C. 333 (1962). The Supreme Court has recognized, however, that the decisive distinctions between current expenses and capital expenditures “are those of degree and not of kind.” Welch v. Helvering, 290 U.S. 111, 114 (1933). Since there is no clear dividing line between deductible repairs and capital expenditures, courts have adopted a practical case-by-case approach in applying the principles of capitalization and deductibility to the facts before them. Wolfsen Land & Cattle Co. v. Commissioner, 72 T.C. 1 (1979).

In the seminal case of Illinois Merchants Trust Co. v. Commissioner, 4 B.T.A. 103 (1926), which involved the cost of shoring up a wall and repairing a foundation needed to prevent a building collapse, the Board of Tax Appeals drew the following distinctions:

A repair is an expenditure for the purpose of keeping the property in an ordinarily efficient operating condition . . . Expenditures for that purpose are distinguishable from those for replacements, alterations, improvements or additions which prolong the life of the property, increase its value, or make it adaptable to a different use. The one is a maintenance charge, while the others are additions to capital which should not be applied against current earnings.

4 B.T.A. at 106.

Taxpayer's position is that all of the environmental cleanup costs at issue are deductible as ordinary and necessary business expenses under section 162. In particular, taxpayer claims that the cleanup activities constitute “repairs” within the meaning of section 1.162-4 of the Income Tax Regulations. Taxpayer also claims that the contamination assessment costs are deductible because they were not incurred in connection with the acquisition of any asset, but simply serve to provide information about contaminated sites preparatory to undertaking appropriate remedial actions. Taxpayer also reasons that because the cleanup expenditures were incurred to correct activities undertaken in the past, the expenditures should be currently deducted and not capitalized and recovered in future years.

Section 1.162-4 of the Income Tax Regulations specifically allows a deduction for a repair cost only if all of the following conditions are met: 1) the repair is incidental; 2) the cost of the repair does not materially add to the value of the property; 3) the repair does not appreciably prolong the useful life of the property; and 4) the purpose of the expenditure is to keep the property in ordinarily efficient operating condition.

The examining agent's position is that the cleanup operations are not incidental repairs; that the cleanup operations do materially add to the value of the property; and that the purpose of the expenditures is not to keep the property in ordinarily efficient operating condition, but to effectuate a general restoration of the property which should be treated as an addition to the capital investment.

A. WHETHER THE CLEANUP ACTIVITIES CONSTITUTE “INCIDENTAL REPAIRS” WITHIN THE MEANING OF SECTION 1.162-4 OF THE REGULATIONS.

The regulations provide that not all expenses incurred in repairing property are deductible. Repair costs, the deduction of which is allowable, are the costs of “incidental repairs.” Bloomfield Steamship Co. v. Commissioner, 33 T.C. 75 (1959), aff'd, 285 F.2d 431 (5th Cir. 1961). In determining whether a repair is incidental, courts look to the nature of the work in relation to the taxpayer's operations, and not solely to the cost of the work performed. Several courts have addressed situations in which work performed on tangible assets was costly in relation to the cost of the asset, and have held that the work was a repair based on the nature of the work in the context of the case. See, e.g., American Bemberg Corp. v. Commissioner, 10 T.C. 361 (1948), aff'd, 177 F.2d 200 (6th Cir. 1949) (costs of drilling and grouting cavities underneath taxpayer's rayon plant held to be deductible); Buckland v. United States, 66 F. Supp. 681 (D. Conn. 1946) (costs of repairing window sills to prevent leaks were deductible even though the expenditure amounted to 35% of the value of the building). Thus, although the cost of the cleanup program in the instant case is significant when compared to the taxpayer's overall capital investment, this factor alone is not dispositive of whether these amounts are deductible.

The Code's capitalization provision envisions an inquiry into the duration and extent of the benefits realized by the taxpayer. See Indopco, Inc. v. Commissioner, supra, at 1045. Courts have held that costs were capital expenditures when the work performed was of considerable significance in view of taxpayers' overall operations. Based on such reasoning, the court in Mountain Fuel Supply Co. v. United States, 449 F.2d 816 (10th Cir. 1971), required the taxpayer to capitalize the costs of digging up, cutting, removing, hauling, straightening, cleaning, spotwelding corrosion pits, removal of defective sections, beveling, bending, reopening trenches, rewelding, relaying, testing and burying of all the old pipe returned to service.

The Tax Court in Wolfsen Land & Cattle Co. v. Commissioner, 72 T.C. 1 (1979) relied on similar reasoning, in holding that the taxpayer was required to capitalize the costs of draglining ditches in an irrigation system on a farm to clear them of sediment and other materials that blocked the flow of water in the ditches. The taxpayer draglined the ditches at the end of 10 years of use instead of maintaining an annual maintenance plan. The court stated that the institution of such a program, as opposed to one of annual maintenance, was the taxpayer's unquestioned right, and that the court's job was only to discern the tax effect of this choice. In its analysis the court noted that the purpose and effect of draglining a ditch was to restore it to its original capacity, and that this was a maintenance-type expense that kept the taxpayer's irrigation system operable. The court nevertheless declined to resolve the issue on such limited grounds, stating that:

In discussing these expenses we do not presume even to attempt to define as words of art such terms as “rehabilitate,” “reconstruct,” “clean,” and “repair.” Even though the parties did try to attribute some definitive meaning to the words, our determination does not depend on resolving the semantic problem.

72 T.C. at 12. The Tax Court found significant the fact that the subject expenditures were part of a systematic plan under which the earthworks on the ranch would be draglined, and analogized the ranch's ditches to the pipelines discussed in Mountain Fuel Supply Co. Thus, the draglining expenditures would have a significant impact on the value of the system, since “[a] cleaned ditch or reworked levee is of more value than is one in need of repair. A more efficient system renders the ranch more productive and valuable . . . Related to this point is the magnitude of the expenditures themselves.” 72 T.C. at 17. The court concluded that the draglining expenditures were more than merely incidental. “They are, rather, in the nature of capital 'replacement' expenditures which must be capitalized and amortized over their appropriate useful lives[.]” 72 T.C. at 18.

The facts in Wolfsen are similar to the facts in this case in several respects. First, like the taxpayer in Wolfsen that chose to forego performing annual ditch maintenance that later resulted in necessitating extensive cleaning operations, taxpayer in the instant case did not institute an ongoing program of waste identification and disposal. Taxpayer could have disposed of the residues in a manner that would have obviated the need for the extraordinary cleanup which is at issue. Taxpayer in this case may argue that unlike Wolfsen, it was unaware that its method of disposal would require a future cleanup. However, as was the case in Wolfsen, the proper characterization of the cleanup operations as deductible repair expenses or capital expenditures depends on an analysis of the work being performed, and not on whether taxpayer was aware of the future consequences of its disposal practices. Second, both taxpayer in the instant case and the taxpayer in Wolfsen made the expenditures as part of a systematic plan involving extensive identification and/or remediation activities throughout its property. Third, according to the reasoning in Wolfsen, taxpayer's property in this case will be more valuable in its business after it is cleaned of PCB residues than property that is in need of remediation.

Taxpayer has cited as a significant distinction the fact that in Wolfsen the cleanup of the irrigation system restored the system to functional use after it became dysfunctional, and that in its case, taxpayer's *** system was not dysfunctional but has operated continuously and without suspension. We do not believe that this is a significant distinction for purposes of determining the correct treatment of taxpayer's expenditures. There are numerous cases that did not involve dysfunctional property in which courts have found that improvements to the property were capital, especially where, as in the present case, taxpayers' modifications were made in compliance with government regulations. See Blue Creek Coal, Inc. v. Commissioner, T.C. Memo. 1984-579 (taxpayer was required to capitalize cost of installing enclosed cabs on bulldozers pursuant to order of federal Mine, Health and Safety Administration; the addition of cabs improved the quality of the bulldozers by meeting safety requirements; the work was not a repair since the bulldozers were operational before the addition of cabs); Teitelbaum v. Commissioner, 294 F.2d 541 (7th Cir. 1961) (taxpayer was required to capitalize cost of converting electrical system from D.C. to A.C. pursuant to a city ordinance, because even though the modifications did not prolong the life of the building they rendered the property more valuable for the taxpayer's use by bringing the property into compliance with applicable regulations); Hotel Sulgrave, Inc. v. Commissioner, 21 T.C. 619 (1954) (taxpayer was required to capitalize cost of installing sprinkler system in old building to comply with City's order because it was a permanent addition which made the property more valuable for use in the taxpayer's business, although it did not increase the value of the hotel property or prolong its useful life); Cerda v. United States, 84-1 USTC section 9490 (N.D. Ill. 1984) (taxpayer was required to capitalize cost of repairs made to plumbing, carpentry and electrical system to keep building in a safe condition in compliance with city building code after taxpayer received notices of violations, because the value of the building was increased by virtue of bringing it into compliance with applicable regulations).

Taxpayer in this case has attempted to distinguish the above line of cases on the grounds that the expenses incurred in those cases would have constituted capital expenditures even if they had not been required in order to meet government regulations, because, it asserts, in each of those cases the taxpayer structurally altered its equipment or facilities. Therefore, the argument continues, the courts required those expenses to be capitalized for reasons apart from the question of whether the expenditures made the asset more valuable for the taxpayer's use in its business. This argument is not supported by the facts in the cases. For instance, in Cerda v. United States the taxpayer made various plumbing, carpentry and electrical repairs that did not include structural alterations. Moreover, the installation of a sprinkler system can be either a capital expenditure or a repair, depending on the context in which the expenditure is incurred. Compare Hotel Sulgrave, supra, in which the cost of a sprinkler system was capitalized, with E.V. Scott v. Commissioner, T.C. Memo. 1979-29, in which the cost of a sprinkler system was deductible because it was installed to repair a foundation. Furthermore, contrary to taxpayer's argument that Wolfsen only requires capitalization of modifications that repair dysfunctional property, in Blue Creek Coal, the court viewed as persuasive the fact that the bulldozers were operational without the cabs, in concluding that the addition of the cabs was not an incidental repair but an improvement.

We also do not agree with taxpayer's view that the environmental cleanup operations do not involve replacements, alterations or improvements. Taxpayer's land in the instant case is no less a capital asset than the equipment and buildings in the cited cases. The expenditures at issue are for extensive replacements of significant sections of land and costs associated with this work. The facts and circumstances demonstrate that these replacements throughout taxpayer's properties result in permanent improvements to taxpayer's system overall because, as was the case in Wolfsen, taxpayer's property will be more valuable in its business after it is cleaned of PCB residues than when it was in need of remediation.

Taxpayer has asserted that if the Service applied the test used by the Tax Court in Plainfield-Union Water Co. v. Commissioner, supra, for determining whether a repair expenditure increases the value of an asset, i.e., whether the property's value is materially higher after the repair compared to the value of the property prior to the condition necessitating the repair, then taxpayer would be entitled to a deduction for its cleanup plan. Taxpayer's assertion, however, does not take into account the fact that although the court in Plainfield-Union viewed the test as one of the determining factors, the decision in that case was based on full consideration of the “entire factual context.” 39 T.C. at 341. The situation in that case is distinguishable from the instant case in that the repair in Plainfield-Union involved “a very minor part of petitioner's operation and was not part of any general plan.” 39 T.C. at 339. Furthermore, if the Plainfield-Union “increase in value” test was the only factor used in determining whether an expenditure should be categorized as a deductible repair or capital expenditure, then any replacement of a capital asset would also be deductible. We do not believe, especially in light of the Tax Court's more recent decision in Wolfsen, that the court intended such a narrow application of the inquiry into value.

Based on our analysis of all the facts and circumstances, the costs of the cleanup project are more appropriately classified as capital expenditures than as maintenance or repair charges.

B. WHETHER THE CLEANUP ACTIVITIES WERE UNDERTAKEN PURSUANT TO A GENERAL PLAN OF REHABILITATION

In addition to the requirements in section 1.162-4 of the regulations that must be met for an expenditure to constitute a deductible repair, courts have superimposed the overriding doctrine that expenses incurred as part of a general plan of rehabilitation or restoration must be capitalized even though the same expense if incurred separately would be deductible as an ordinary and necessary business expense. Whether there is a plan of rehabilitation is a question of fact. Wehrli v. United States, 400 F.2d 686 (10th Cir. 1968); Stoeltzing v. Commissioner, 266 F.2d 374 (3d Cir. 1959).

For example, in Jones v. Commissioner, 242 F.2d 616 (5th Cir. 1957), the taxpayer was required to make repairs to its rental building that entailed repairing cracks in masonry, waterproofing exterior walls, replastering and painting, and overhauling the roof, plumbing and electrical equipment. The taxpayer undertook to show that each of the items of work done were repair items. The court dismissed the taxpayer's showing because of the following:

From this [the taxpayer] reasons that if the parts are repairs the whole can not be otherwise. Whether or not the initial premise be sound we do not think the conclusion follows . . . "The difficulty inherent in determining the character of a particular expenditure is illustrated by the fact that a particular item, standing alone or made as periodic repairs, might be deductible as an ordinary and necessary business expense, but if made as a part of an entire capital investment in the improved property, may be treated as a capital expenditure." Mertens, Law of Federal Income Taxation, section 25.41.
242 F.2d at 619.
Similar work was performed in Cowell v. Commissioner, 18 B.T.A. 997 (1930), which involved modifications to a hotel building. The work included replacing electric wiring and plumbing, installing a new heating system, modifying the interior, replacing a roof, windows and sheet metal facing, repairing and replacing plaster and concrete, and painting. The court held that the cost of all the items must be capitalized, stating that classification as a repair "is not a mere matter of what an item is called, but whether it is a part of the entire capital investment in the improved property." 18 B.T.A. at 1002.

In Bank of Houston v. Commissioner, T.C. Memo. 1960-110 (1960), the taxpayer's building was in general disrepair but still serviceable for the purposes used and was in good structural condition. The taxpayer made nonstructural repairs to flooring, electrical wiring, plaster, window frames, patched brick, painted, and performed plumbing repairs, demolition and cleanup. The court recognized that each phase of the remodeling project, removed in time and context, might be considered a repair item, but stated that "[t]he Code, however, does not envision the fragmentation of an over- all project for deduction or capitalization purposes." The court held that the expenditures were not made for incidental repairs but were part of an overall plan for the general rehabilitation, restoration and improvement of the old building.

The general plan of rehabilitation doctrine has been applied in cases other than those which involved modifications to one building. In Mountain Fuel Supply Co. v. United States, 449 F.2d 816 (10th Cir. 1971) the taxpayer's rehabilitation project involved the digging up of 40 miles of gas pipeline, hauling it to a central location, straightening the line, cutting out defective portions, cleaning, sandblasting and spotwelding the remainder, hauling it back and reinstalling it with new coal tar and fabric coating. Only 10 per cent of new pipe was installed. The Court of Appeals reversed the District Court's decision that the work was not a part of any general plan of betterment, stating that “it is apparent that the taxpayer did embark upon a particular program of rehabilitation which was well defined in scope and was of considerable significance in view of its overall operations and funds available.”

The cleanup operations in this case constitute a general plan of rehabilitation and restoration of taxpayer's properties. The cleanup program is a long-term systematic program that involves systematically testing, assessing, remediating, removing and replacing extensive amounts of land. The cleanup operations taken in their entirety, will result in permanent betterments to taxpayer's properties that comprise its system. These betterments include, but are not limited to, transforming sections of contaminated land into land that is no longer contaminated, avoiding further government penalties by bringing the properties into compliance with government regulations, providing a safe environment for workers and adjoining property owners, and increasing the marketability of the properties once the level of PCBs is brought within the safety range permitted under the environmental regulations. Accordingly, the cleanup project constitutes a general plan of rehabilitation, the costs of which are required to be capitalized.

Issue 2 -- Legal fees and oversight and environmental audit costs.
The deductibility of legal fees and related expenses is determined from the character of the suit in connection with which they were expended. Kelly v. Commissioner, 23 T.C. 682 (1955). Legal expenses paid in connection with litigation are generally deductible as business expenses under section 162 where the legal proceeding threatens the safety of the taxpayer's business. Commissioner v. Tellier, 383 U.S. 687 (1965) (litigation expenses for unsuccessful defense against prosecution for securities fraud held deductible as ordinary and necessary business expenses); Commissioner v. Heininger, 320 U.S. 467 (1943) (legal expenses to enjoin enforcement of mail fraud order held deductible as ordinary and necessary business expenses). However, where the legal expenses create or enhance a separate asset or produce a long-term benefit they must be capitalized. This is a question of fact. See Commissioner v. Lincoln Savings & Loan Ass'n, 403 U.S. 345 (1971); Indopco, Inc. v. Commissioner, supra.

Taxpayer incurred legal fees for numerous activities in connection with the PCB contamination. The legal costs incurred to respond to the claims of the EPA and state agencies, to defend against claims by private third parties and to litigate insurance matters did not create or enhance an asset or produce a long-term benefit. These expenses were incurred to protect taxpayer's business by defending it against claims, and securing its contractual rights with insurers. The expenses were not incurred to facilitate the environmental cleanup and are not part of the plan of rehabilitation. These expenses are therefore deductible as ordinary and necessary business expenses.

Taxpayer also incurred oversight costs in connection with the cleanup operations required of taxpayer under the EPA Consent Decree and state orders and agreements. The oversight costs are incurred pursuant to the plan of rehabilitation. Therefore, these costs must be capitalized as part of the rehabilitation, even though they may be paid for the services of employees and contractors of the EPA and state agencies.

The facts regarding the environmental audit costs require further development by the field before a determination of the appropriate tax treatment can be made. The facts regarding the compliance manual also require further development in order to determine the appropriate tax treatment. The tax treatment of the costs of developing the compliance manual depends on whether the manual is part of the plan of rehabilitation, is a separate asset of the taxpayer, or will undergo periodic modification with attendant recurring costs.

Conclusion

Issue 1. Under the facts and circumstances of this case, the costs of the environmental cleanup activities are capital expenditures. The extensive modifications to taxpayer's property under the cleanup operation constitute replacements and betterments, and not repairs within the meaning of section 1.162-4 of the Income Tax Regulations. In addition, the cleanup operation constitutes a general plan of rehabilitation and restoration of properties throughout taxpayer's *** system. The rehabilitation will benefit taxpayer's property for the duration of the useful life of the *** system. Accordingly, the costs attributable to the rehabilitation should be *** capitalized as an addition to the cost of *** property for purposes of cost recovery, and not capitalized to the land. Such costs generally include but are not limited to expenditures for assessment, remediation, transportation and disposal of contaminated soil, and new soil.

There are some costs at issue that may not be attributable to the plan of rehabilitation, such as costs to assess contamination of property that does not undergo rehabilitation as a result of the assessment. These costs may be deducted if it is determined that an assessed site will not undergo rehabilitation. The deductibility of these and other costs that may not be appropriately charged to capital are subject to further factual examination by the examining agent.

The factual record is insufficient to determine whether costs for research and development of alternative technologies in the remediation of PCB-contaminated soils are deductible under any provision of the Code. The deductibility of these costs is subject to further examination by the examining agent.

Issue 2. The legal fees with respect to claims against taxpayer by state and federal agencies and private third parties, and litigation between taxpayer and insurance companies, are deductible to the extent that they were incurred to defend taxpayer's business or secure contractual rights. These costs did not contribute to or facilitate the environmental cleanup.

The oversight costs required as part of the cleanup operations pursuant to the *** state orders and administrative agreements, should be capitalized as costs of the cleanup project.

The factual record is insufficient to determine whether costs incurred for environmental audits and a PCB compliance manual are deductible expenses. The factual record is also insufficient to determine whether costs for *** are deductible. The deductibility of these costs is subject to further factual examination by the examining agent.

A copy of this technical advice memorandum is to be given to the taxpayer. Section 6110(j)(3) of the Code provides that this memorandum may not be used or cited as precedent.