Northville Dock Corp. v. Commissioner, 52 T. C. 68 (1969)

Storage facilities used in connection with manufacturing, production, or extraction activities qualify for the investment tax credit under Section 38 of the Internal Revenue Code.

Summary

Northville Dock Corp. sought an investment tax credit for two new oil storage tanks placed into service in 1963. Tank 413 was used to blend oils, qualifying as an integral part of production, while Tank 212 stored oil for refineries, used substantially in connection with refining. The Tax Court held both tanks were Section 38 property, eligible for the credit, rejecting the IRS's argument that storage facilities must be predominantly used for the prescribed activities. This ruling clarified that facilities need only be used in connection with qualifying activities, not predominantly so, broadening the scope of the investment credit.

Facts

Northville Dock Corp. , a New York corporation, placed two new oil storage tanks into service in 1963. Tank 413 was used to blend No. 2 and No. 6 oil to produce No. 4 oil, a process akin to oil refining. Tank 212 stored No. 2 oil, some of which was owned by Northville, while a significant portion was held for oil refineries like Humble, American, and Shell. Northville claimed an investment credit of $20,444. 85 on its 1964 tax return based on the tanks' cost basis. The IRS disallowed the credit, asserting the tanks did not qualify as Section 38 property.

Procedural History

Northville Dock Corp. filed a petition with the U. S. Tax Court challenging the IRS's disallowance of the investment tax credit. The Tax Court heard the case and issued its opinion on April 9, 1969, ruling in favor of Northville and allowing the credit.

Issue(s)

1. Whether Tank 413, used to blend oils, qualifies as Section 38 property because it is an integral part of the manufacturing or production process.
2. Whether Tank 212, used to store oil for refineries, qualifies as Section 38 property because it is used in connection with the refining process, despite not being used predominantly for that purpose.

Holding

1. Yes, because Tank 413 was used to blend oils, constituting the production of a new product, thus qualifying as Section 38 property.
2. Yes, because Tank 212 was substantially used to store oil for refineries, which is in connection with their refining process, and the statute requires only use in

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connection with, not predominant use.

Court’s Reasoning

The court interpreted Section 48 of the Internal Revenue Code, which defines Section 38 property to include storage facilities used in connection with manufacturing, production, or extraction. The court emphasized the broad definition of these activities in the regulations, which include blending or combining materials to create a new product, as was done in Tank 413. For Tank 212, the court rejected the IRS’s reliance on a revenue ruling requiring predominant use, noting that neither the Code nor regulations imposed such a requirement. The court found that substantial use in connection with the prescribed activities was sufficient for Section 38 property qualification. The court also cited examples from regulations allowing less than predominant use to still qualify property for the credit, and noted the absence of a predominant-use test in the relevant sections of the Code.

Practical Implications

This decision expands the eligibility for the investment tax credit by clarifying that storage facilities need only be used in connection with qualifying activities, not predominantly so. This ruling benefits businesses that use storage facilities as part of their manufacturing, production, or extraction processes, even if those facilities are not exclusively dedicated to such activities. Tax practitioners should consider this ruling when advising clients on potential investment credits, especially in industries where storage is integral but not the primary function of the facility. The decision may lead to increased claims for the investment credit by businesses with mixed-use storage facilities. Subsequent cases have applied this ruling to affirm the credit for various types of storage facilities, while distinguishing it in cases where the connection to qualifying activities was deemed too tenuous.

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