***Lockhart Leasing Co. v. Commissioner, 54 T. C. 301 (1970)***

A lessor is entitled to the investment tax credit on leased equipment if the transaction is a true lease in substance and form, allowing depreciation to the lessor.

**Summary**

Lockhart Leasing Co. purchased equipment and leased it to various lessees, claiming investment tax credits under IRC Section 38. The IRS challenged these claims, arguing the transactions were financing arrangements or conditional sales, not true leases. The Tax Court held that the transactions were leases in substance and form, entitling Lockhart to the investment credit for equipment leased over 4 years, except where the lessee had prior use or the credit was passed to the lessee. This decision hinged on the court's analysis of the lease agreements, the parties' conduct, and the economic realities of the transactions.

**Facts**

Lockhart Leasing Co. , a Utah corporation, purchased various types of equipment and leased them to different lessees under 'Equipment Lease Agreements. ' These agreements typically required the lessee to pay all taxes and insurance, maintain the equipment, and return it at the lease's end. Some leases included purchase options at 10% of the equipment's cost. Lockhart claimed depreciation and investment credits on its tax returns, which the IRS challenged, asserting the transactions were financing arrangements or conditional sales.

**Procedural History**

The IRS issued deficiency notices for Lockhart's fiscal years ending September 30, 1962, and 1964, disallowing the claimed investment credits. Lockhart petitioned the U. S. Tax Court, which held hearings and received evidence before issuing its decision.

**Issue(s)**

1. Whether the transactions between Lockhart and its lessees were true leases entitling Lockhart to claim depreciation and investment credits under IRC Section 38.

**Holding**

1. Yes, because the transactions were leases in substance and form, allowing Lockhart to claim depreciation and investment credits on equipment leased for over 4 years, except where the lessee had prior use or the credit was passed to the lessee.

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## Court’s Reasoning

The court focused on the substance of the transactions, noting that while the form was a lease, the IRS argued it was a financing arrangement or conditional sale. The court analyzed the lease terms, including the absence of title transfer, the lessee’s obligations, and the economic realities of the transactions. It found that Lockhart purchased the equipment outright, had no repurchase agreements with vendors, and the rental payments were fair for the equipment’s use. The court distinguished this case from others where equipment was an addendum to property or where purchase options were nominal. The court concluded that the transactions were true leases, entitling Lockhart to depreciation and investment credits, except where the equipment had been used by the lessee before leasing or where Lockhart passed the credit to the lessee.

## Practical Implications

This decision clarifies that for investment tax credit purposes, a lessor can claim the credit if the transaction is a true lease, allowing depreciation to the lessor. It emphasizes the importance of analyzing the substance of lease agreements, including the parties’ obligations and the economic realities of the transactions. Practitioners should carefully draft lease agreements to ensure they meet the criteria for true leases, particularly regarding title transfer, maintenance responsibilities, and purchase options. This case may impact how businesses structure lease transactions to maximize tax benefits while ensuring they are treated as leases for tax purposes.

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