Giumarra Bros. Fruit Co. , Inc. v. Commissioner of Internal Revenue, 55 T. C. 460, 1970 U. S. Tax Ct. LEXIS 15 (U. S. Tax Court 1970)

The cost of acquiring a lease is amortizable over the remaining term of the lease plus any option period, as specified by Internal Revenue Code Section 178(a), when less than 75% of the cost is attributable to the remaining prime term.

Summary

Giumarra Bros. Fruit Co. paid $40,000 to acquire additional leased space for its wholesale produce business, with 17 months left on the original lease term and a one-year renewal option. The key issue was whether this cost should be amortized over the 29-month period (17 months plus the option) or over an indefinite period. The U. S. Tax Court held that the payment should be amortized over the 29 months, applying Section 178(a) of the Internal Revenue Code, as less than 75% of the cost was attributable to the remaining prime term of the lease. This decision clarifies the amortization period for lease acquisition costs and provides a clear framework for businesses in similar situations.

Facts

Giumarra Bros. Fruit Co. , a wholesale fruit and produce distributor, leased space from Los Angeles Union Terminal, Inc. In December 1965, Giumarra leased 4,800 square feet for two years with a one-year renewal option. In June 1966, Giumarra paid $40,000 to acquire an adjacent 3,200 square feet of space that became available due to another tenant’s bankruptcy. This payment was made to the receiver of the bankrupt tenant to satisfy creditors’ claims. The supplemental lease increased Giumarra’s monthly rent from $432 to $928, effective July 1, 1966. Giumarra’s officers believed the additional space would be profitable over the remaining 17 months of the original lease term plus the one-year renewal option.

Procedural History

The Commissioner of Internal Revenue determined a deficiency in Giumarra’s income tax for the taxable year ending April 30, 1967, due to the disallowance of Giumarra’s claimed amortization deduction of $20,000 for the lease acquisition cost. Giumarra petitioned the U. S. Tax Court for a redetermination of the deficiency. At trial, Giumarra conceded that the $40,000 should be amortized over 29 months but argued for a specific calculation under Section 178(a) of the Internal Revenue Code.

Issue(s)

1. Whether the $40,000 paid by Giumarra Bros. Fruit Co. to acquire additional leased space is amortizable over the 29-month period (17 months of the original lease term plus the one-year renewal option) under Section 178(a) of the Internal Revenue Code.

Holding

1. Yes, because less than 75% of the $40,000 cost was attributable to the remaining prime term of the lease, making Section 178(a) applicable, which requires amortization over the 29-month period.

Court's Reasoning

The court applied Section 178(a) of the Internal Revenue Code, which governs the amortization of lease acquisition costs. The court determined that less than 75% of the $40,000 was attributable to the remaining 17 months of the prime term of the lease, thus requiring amortization over the 29-month period (17 months plus the one-year option). The court rejected the Commissioner's argument that the payment should be considered an intangible asset with an indefinite useful life, citing that the payment was specifically for acquiring the leasehold. The court also noted that the legislative history of Section 178 aimed to provide a clear rule for amortizing such costs, avoiding the need to determine "reasonable certainty" of lease renewals. The court's decision was supported by the regulations under Section 178, which provide a formula for determining the portion of the cost attributable to the prime term versus the option period.

Practical Implications

This decision clarifies that businesses can amortize lease acquisition costs over the specified lease term, including any option period, as long as less than 75% of the cost is attributable to the remaining prime term. This ruling provides a practical framework for tax planning and accounting for leasehold improvements. Businesses in similar situations can now confidently calculate their amortization deductions without needing to prove "reasonable certainty" of lease renewals. The decision may also influence how lease agreements are structured and negotiated, as parties may consider the tax implications of lease acquisition costs. Subsequent cases have applied this ruling to similar lease acquisition scenarios, reinforcing the importance of Section 178 in determining the amortization period for such costs.

