Tri-City Dr. Pepper Bottling Co. v. Commissioner, 61 T. C. 508 (1974)

A subchapter S election triggers the investment credit recapture tax unless the corporation and its shareholders sign an agreement to defer the tax until the property ceases to be section 38 property.

Summary

Tri-City Dr. Pepper Bottling Company elected to become a subchapter S corporation for its fiscal year starting April 1, 1969. Prior to this election, it had claimed investment tax credits. The IRS argued that this election triggered a recapture tax under Treasury Regulation section 1. 47-4(b), which the company challenged. The Tax Court upheld the regulation's validity, ruling that the subchapter S election caused the company's section 38 property to cease being such with respect to the company, thereby triggering the recapture tax. The court emphasized that the regulation reasonably implemented the statutory scheme by allowing the tax to be deferred if an agreement was signed.

Facts

Tri-City Dr. Pepper Bottling Company, a Texas corporation, had claimed and been allowed investment tax credits under section 38 for taxable years prior to the one ending March 31, 1969. For the fiscal year ending March 31, 1969, it claimed an additional investment credit of $1,222. 66. Effective April 1, 1969, the company elected to become a subchapter S corporation under section 1372. Neither the company nor its shareholders executed the agreement prescribed by Treasury Regulation section 1. 47-4(b)(2) to defer the recapture tax. The IRS disallowed the claimed investment credit for the fiscal year ending March 31, 1969, and determined a deficiency due to the recapture tax on previously claimed credits totaling $4,246. 42.

Procedural History

The IRS issued a notice of deficiency to Tri-City Dr. Pepper Bottling Company for the fiscal year ending March 31, 1969, asserting a deficiency of $5,469. 08 due to the disallowance of the investment credit and the imposition of a recapture tax. The company petitioned the U. S. Tax Court for a redetermination of the deficiency. The Tax Court upheld the validity of Treasury Regulation section 1. 47-4(b) and ruled in favor of the Commissioner.

Issue(s)

1. Whether Treasury Regulation section 1. 47-4(b) is valid in causing section 38 property to be considered as having ceased to be section 38 property with respect to the taxpayer upon a subchapter S election?

Holding

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1. Yes, because the regulation reasonably implements section 47(a)(1) by triggering the recapture tax upon a subchapter S election unless an agreement is signed to defer the tax.

Court's Reasoning

The Tax Court held that Treasury Regulation section 1. 47-4(b) is a valid implementation of section 47(a)(1). The court reasoned that the subchapter S election caused the company's section 38 property to cease being such with respect to the company, as the shareholders would be treated as the taxpayers with respect to the property under section 48(e). The court emphasized that the regulation served the purposes of both the investment credit and subchapter S provisions by allowing the recapture tax to be deferred if the corporation and its shareholders signed an agreement. The court rejected the company's argument that the election was merely a change in the form of conducting the business, noting that section 47(b) applies only to transfers of property. The court also noted that the regulation was more liberal than the statute would be without it, as it provided an option to defer the recapture tax.

Practical Implications

This decision clarifies that a subchapter S election can trigger the investment credit recapture tax unless the corporation and its shareholders sign an agreement to defer the tax. Corporations considering a subchapter S election should be aware of this potential tax consequence and consider executing the required agreement to avoid an immediate recapture tax liability. The ruling reinforces the importance of Treasury regulations in implementing the statutory scheme and the deference courts give to such regulations. It also highlights the interplay between different tax provisions and the need to consider the impact of one election on other tax benefits.

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