Blevins v. Commissioner, 61 T. C. 547, 1974 U. S. Tax Ct. LEXIS 161, 61 T. C. No. 59 (1974)

A reduction in a taxpayer's interest in a business following a change in the form of conducting that business can trigger recapture of previously claimed investment tax credits, even if the taxpayer retains a substantial interest post-reduction.

Summary

In Blevins v. Commissioner, the Tax Court held that W. Frank Blevins must recapture 53. 33% of investment tax credits claimed in 1965 and 1966 after gifting stock that reduced his corporate interest from 45% to 21%. Initially a partner in Franklin Furniture Co. , Blevins converted the partnership into a corporation under IRC § 351, maintaining his 45% interest. The key issue was whether the subsequent reduction in interest triggered recapture under IRC § 47(a)(1). The court ruled that despite retaining a substantial interest, the reduction in Blevins' interest post-conversion necessitated partial recapture, applying the partnership interest reduction rules of Treas. Reg. § 1. 47-6(a)(2) as directed by § 1. 47-3(f)(5)(iv).

Facts

W. Frank Blevins owned a 45% interest in Franklin Furniture Co. , a partnership, from December 1, 1965, to December 31, 1966. The partnership purchased IRC § 38 property, entitling Blevins to investment tax credits. On December 31, 1966, the partnership converted into Franklin Furniture Corp. under IRC § 351, with Blevins retaining a 45% interest in the corporation. On July 1, 1968, Blevins gifted stock to his sons, reducing his interest to 21%. The § 38 property had been in use for less than 4 years at the time of the gifts.

Procedural History

The Commissioner determined a deficiency in Blevins' 1968 income tax due to the recapture of investment tax credits. Blevins petitioned the U. S. Tax Court, which ruled in favor of the Commissioner, ordering a recapture of 53. 33% of the credits claimed in 1965 and 1966.

Issue(s)

1. Whether a reduction in a taxpayer's interest in a corporation, following the conversion of a partnership to a corporation, triggers recapture of investment tax credits under IRC § 47(a)(1)?

2. Whether Treas. Reg. § 1. 47-6(a)(2) applies to determine recapture when a taxpayer's interest in a business is reduced after a change in the form of conducting that business?

Holding

1. Yes, because the reduction in interest from 45% to 21% in the corporation, which was a successor to the partnership, triggered recapture under IRC § 47(a)(1) as it was a reduction in interest post-conversion.
2. Yes, because Treas. Reg. § 1. 47-3(f)(5)(iv) directs the application of § 1. 47-6(a)(2) to determine recapture in such situations, leading to a partial recapture of credits.

Court's Reasoning

The Tax Court applied IRC § 47(a)(1), which mandates recapture if property ceases to be § 38 property with respect to the taxpayer before the end of its useful life. IRC § 47(b) provides an exception for mere changes in the form of conducting a trade or business, but only if the taxpayer retains a substantial interest and the property remains § 38 property. The court noted that the exception in § 47(b) is contingent on the "so long as" conditions being met continuously post-conversion. When Blevins' interest was reduced, the court applied Treas. Reg. § 1. 47-3(f)(5)(iv), which directs the use of § 1. 47-6(a)(2) for partnership interest reductions, to determine the recapture amount. The court found that a 53. 33% reduction in Blevins' interest warranted a corresponding 53. 33% recapture of the credits. The court clarified that even though Blevins retained a substantial interest post-reduction, the specific regulations governing partnerships applied to the reduction in interest, necessitating recapture.

Practical Implications

This decision impacts how investment tax credit recapture is analyzed post-conversion of business forms. Taxpayers must be aware that reductions in their interest in a business, even if remaining substantial, can trigger recapture if the reduction occurs within the useful life period of the § 38 property. Legal practitioners must carefully consider the implications of any change in ownership interest post-conversion to advise clients on potential recapture liabilities. The ruling also underscores the importance of understanding the interplay between IRC § 47 and the relevant Treasury Regulations. Subsequent cases, such as Charbonnet v. United States, have distinguished this ruling by focusing on different business structures and applying different regulations. This case serves as a reminder to businesses to plan ownership changes carefully to manage tax liabilities effectively.

