LTV Corp. v. Commissioner, 63 T. C. 39 (1974)

For tax purposes, property is considered acquired when it is installed and operational, and a transaction structured as a lease may be treated as such if it lacks indicia of a conditional sale.

Summary

LTV Corp. entered into a lease agreement with Boothe Leasing Corp. for an IBM 7090 Data Processing System, which was installed on LTV's premises in early 1962. The court addressed whether LTV was eligible for an investment credit and whether the transaction should be treated as a lease or a conditional sale for tax purposes. The court held that the computer was acquired in 1962 for investment credit purposes, as it was not fully operational until then. Additionally, the transaction was deemed a true lease, allowing LTV to deduct rental payments, due to the absence of equity buildup and other factors indicating a conditional sale.

Facts

LTV Corp. entered into an "Equipment Lease Agreement" with Boothe Leasing Corp. on October 23, 1961, to lease an IBM 7090 Data Processing System. The lease term began on January 23, 1962. Boothe purchased the computer from IBM, which was responsible for its installation at LTV's Arlington, Texas facility. The computer arrived in mid-December 1961, but installation was not completed until mid-January 1962. LTV claimed an investment credit for the computer on its 1962 tax return and treated the transaction as a lease for tax purposes, deducting the rental payments.

Procedural History

The Commissioner of Internal Revenue determined deficiencies in LTV's federal income tax for 1962-1964, disallowing the investment credit and recharacterizing the lease as a conditional sale. LTV petitioned the U. S. Tax Court, which heard the case and ruled in favor of LTV on both issues.

Issue(s)

1. Whether the IBM 7090 Data Processing System constitutes "new section 38 property" acquired after December 31, 1961, for the purposes of the investment credit?
2. Whether the transaction between LTV and Boothe should be characterized as a lease or a conditional sale for tax purposes?

Holding

1. Yes, because the computer was not fully installed and operational until January 1962, making it "new section 38 property" acquired after December 31, 1961.
2. Yes, because the transaction lacked the indicia of a conditional sale, such as an

option price that approximated the computer's fair market value at the end of the lease term and did not allow rental payments to offset the option price.

Court's Reasoning

The court determined that for investment credit purposes, property is acquired when it is installed and operational, not merely when it is delivered. The court relied on testimony and evidence showing the computer was not fully operational until January 1962. Regarding the lease versus sale issue, the court considered the economic substance of the transaction, focusing on the burdens of ownership, the option price, the sum of rental payments, and their comparison to the computer's fair rental value. The court found that the transaction did not exhibit the characteristics of a conditional sale, as the option price was set at the computer's estimated fair market value after five years, and rental payments were not excessive compared to the fair rental value. The court also noted the rapid obsolescence in computer technology as a factor justifying higher front-end rental payments.

Practical Implications

This decision clarifies that for investment credit eligibility, the date of acquisition is when the property is fully installed and operational, which is critical for timing investment credit claims. For lease versus sale determinations, the court's focus on economic substance over form provides guidance for structuring transactions to achieve desired tax treatment. Businesses leasing high-tech equipment should consider the terms of their agreements carefully to ensure they meet the criteria for lease treatment, especially given the rapid technological changes. Subsequent cases have followed this reasoning, impacting how similar transactions are analyzed and structured for tax purposes.

