United Telecommunications, Inc. (Formerly United Utilities Incorporated), Petitioner v. Commissioner of Internal Revenue, Respondent, 65 T. C. 278 (1975)

The basis of self-constructed new section 38 property includes depreciation on assets used in its construction, but only if no investment credit was previously claimed on those assets.

Summary

United Telecommunications, Inc. sought to include depreciation on construction equipment in the basis of self-constructed telephone and power plant properties for calculating the investment tax credit. The Tax Court held that such depreciation could be included in the basis for determining qualified investment if no investment credit had been claimed on the construction equipment. The court invalidated a regulation that excluded all construction-related depreciation from the basis, ruling it inconsistent with the statute. This decision allows taxpayers to include certain depreciation in the basis of self-constructed assets for investment credit purposes, impacting how similar cases should be analyzed and potentially affecting business decisions on self-construction versus purchasing assets.

Facts

United Telecommunications, Inc. 's subsidiaries constructed telephone and power plant properties, qualifying as new section 38 property. They used their own equipment in the construction process, and the depreciation on this equipment was capitalized into the cost basis of the new property, following regulatory requirements. The taxpayer included this capitalized depreciation in the basis for calculating the investment tax credit. The Commissioner challenged this inclusion, leading to the dispute over whether such depreciation should be part of the basis for determining the qualified investment.

Procedural History

The case was initiated in the U. S. Tax Court following the Commissioner's determination of deficiencies in United Telecommunications, Inc. 's income tax for the years 1964 and 1965. The taxpayer claimed a refund for 1964. After concessions, the sole issue before the court was the inclusion of construction-related depreciation in the basis of self-constructed new section 38 property for investment credit purposes. The Tax Court issued its opinion on November 10, 1975, partially invalidating a regulation and ruling in favor of the taxpayer on the central issue.

Issue(s)

1. Whether the basis of self-constructed new section 38 property, for purposes of determining qualified investment, includes the capitalized depreciation of property used in its construction when no investment credit has been claimed on that

property?

Holding

1. Yes, because the statute defines basis generally as cost, and the legislative history supports including all costs in the basis of new section 38 property. The court found that excluding depreciation on non-credited assets from the basis was inconsistent with the statute's intent to encourage capital investment by reducing the net cost of acquiring assets.

Court's Reasoning

The court interpreted the term "basis" in section 46(c)(1)(A) and section 48(b) to mean the general and ordinary economic basis, which includes depreciation costs. The legislative history of the investment credit, as enacted by the Revenue Act of 1962, supported this interpretation by stating that the basis should be determined under general rules, i. e. , cost. The court distinguished between new and used section 38 property, noting that Congress placed specific restrictions on the basis of used property to prevent double credits, but no such restrictions were placed on new property. The court invalidated part of section 1. 46-3(c)(1) of the regulations that excluded all construction-related depreciation from the basis, as it went beyond the statutory intent and was inconsistent with the purpose of the investment credit to stimulate economic growth through capital investment. The court emphasized the need to liberally construe the investment credit provisions to achieve their economic objectives. A concurring opinion suggested a narrower interpretation of the regulation, but the majority's view prevailed.

Practical Implications

This decision clarifies that taxpayers can include depreciation on construction equipment in the basis of self-constructed assets for investment tax credit purposes if no credit was previously claimed on that equipment. This ruling impacts how similar cases should be analyzed, allowing for a broader definition of basis in self-construction scenarios. It may influence businesses to opt for self-construction over purchasing assets, as they can now factor in certain depreciation costs into their investment credit calculations. The decision also highlights the need for careful review of regulations against statutory intent, as the court invalidated a regulation deemed inconsistent with the law. Subsequent cases, such as those involving the new progress expenditure provisions added in 1975, may need to consider this ruling when determining the basis for investment credits on self-constructed property.