Westroads, Inc. v. Commissioner, 69 T. C. 682 (1978)

Electrical generating equipment installed for profit and used to supply electricity to tenants qualifies for investment tax credit as tangible property used in furnishing electrical energy services.

Summary

Westroads, Inc. , owner of a shopping center, installed electrical generating equipment to sell electricity to its tenants, utilizing waste heat for heating and cooling. The IRS denied an investment tax credit under section 38, arguing the equipment was a structural component of the building. The U. S. Tax Court held that the equipment qualified for the credit because it was tangible personal property used as an integral part of furnishing electrical energy services, not merely a structural component. This decision hinges on the equipment's use for generating profit from electricity sales, distinguishing it from cases where such equipment was deemed integral to the building itself.

Facts

Westroads, Inc. owned and operated a regional shopping center in Omaha, Nebraska. To enhance profitability, Westroads installed a 'total energy system' that included electrical generating equipment powered by three dual-fuel engines. The system generated electricity for sale to tenants, with waste heat used to supplement heating and air conditioning. The equipment was installed in the fiscal year ending January 31, 1969, with additional standby equipment added in 1973. Westroads claimed an investment tax credit for the cost of the generating equipment, which the IRS disallowed, asserting it was a structural component of the building.

Procedural History

The IRS issued a notice of deficiency to Westroads for the taxable year ending January 31, 1973, disallowing the claimed investment tax credit. Westroads petitioned the U. S. Tax Court for a redetermination of the deficiency. The Tax Court, after considering the evidence and arguments, ruled in favor of Westroads, allowing the investment tax credit for the electrical generating equipment.

Issue(s)

1. Whether the electrical generating equipment installed by Westroads qualifies as section 38 property under section 48(a)(1)(A) as tangible personal property?
2. Whether the equipment qualifies as section 38 property under section 48(a)(1)(B) as tangible property used as an integral part of furnishing electrical energy services?

Holding

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1. Yes, because the dual-fuel engines and generators constitute tangible personal property under the common understanding of the term.
2. Yes, because the installation was used as an integral part of supplying electrical energy to tenants, not as a structural component of the building, and was installed to generate profit.

Court’s Reasoning

The court applied sections 38 and 48 of the Internal Revenue Code, which define section 38 property as either tangible personal property or other tangible property used as an integral part of furnishing electrical energy services, excluding structural components of buildings. The court found that the electrical generating equipment, including the engines and generators, was tangible personal property. Additionally, the court emphasized that the equipment’s primary purpose was to generate and sell electricity to tenants, thus qualifying as an integral part of furnishing electrical energy services. The court distinguished this case from others where similar equipment was deemed structural components, noting that Westroads’ equipment was installed for profit, not merely as part of the building’s infrastructure. The court also referenced Revenue Ruling 70-103, which supported the classification of standby equipment as tangible personal property eligible for the investment tax credit.

Practical Implications

This decision clarifies that equipment installed for the purpose of generating and selling electricity to tenants, rather than for building maintenance or operation, may qualify for the investment tax credit. Legal practitioners should analyze the primary purpose of equipment installations when advising clients on potential tax credits. Businesses operating commercial properties may consider installing their own energy systems to increase profitability and take advantage of tax incentives. This ruling has influenced subsequent cases, such as Hayden Island, Inc. v. United States, where the court considered the profit motive in determining tax credit eligibility. The decision also highlights the importance of distinguishing between equipment used for profit and that used as a structural component of a building when applying for tax credits.

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