Clyde W. Harrington v. Commissioner of Internal Revenue, 70 T. C. 519 (1978)

The original use of leased property for investment tax credit purposes begins with the lessor, not the lessee, unless an election is made under section 48(d).

Summary

Clyde W. Harrington, a construction business operator, claimed investment tax credits for construction equipment he purchased after renting it. The issue was whether Harrington qualified for the credit under section 38, given he used the equipment before purchasing it. The Tax Court held that the equipment did not qualify as "new section 38 property" because the original use began with the lessor, not Harrington, and no election was made under section 48(d) to pass the credit to the lessee. This ruling clarifies that for investment tax credit purposes, the lessor is considered the original user of leased property unless an election is made to treat the lessee as the first user.

Facts

During 1972 and 1973, Clyde W. Harrington, a resident of Greenville, N. C. , operated a construction business using heavy equipment. He rented new equipment under agreements that allowed him to purchase the equipment at any time, with a credit for a percentage of rental payments against the purchase price. In 1972 and 1973, Harrington purchased four pieces of equipment he had previously rented: a John Deere 310 Loader Backhoe, a Grad-O-Mat Lazer, a J. D. 450 Bulldozer, and a J. D. 500-C Backhoe. He claimed investment tax credits on these purchases, asserting he was the first user of the equipment.

Procedural History

The Commissioner of Internal Revenue determined deficiencies in Harrington's income tax for 1972 and 1973, including additions to the tax. After settling other issues, the remaining issue was whether the purchased equipment qualified for the investment credit under section 38. The case was reassigned from Judge Charles R. Simpson to Judge Herbert L. Chabot for disposition. The Tax Court issued its opinion on the remaining issue.

Issue(s)

1. Whether the construction equipment purchased by Harrington after renting it qualifies as "new section 38 property" for the purposes of claiming the investment tax credit under section 38.

Holding

1. No, because the original use of the equipment commenced with the lessor, not

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Harrington, and no election under section 48(d) was made by the lessor to treat Harrington as the first user for investment credit purposes.

Court’s Reasoning

The Tax Court reasoned that under section 48(b)(2), “new section 38 property” requires that the original use of the property commences with the taxpayer. The court concluded that the lessor is typically considered the original user of leased property, as the lessor’s use in leasing operations constitutes the initial use. The court noted that section 48(d) allows a lessor to elect to pass the investment credit to the lessee, but no such election was made in this case. The court supported its interpretation with legislative history from the Revenue Act of 1962, which indicated that the original use of leased property begins with the lessor unless an election is made. The court emphasized that Harrington’s use of the equipment as a lessee did not qualify as the “original use” necessary for the investment credit.

Practical Implications

This decision has significant implications for businesses and individuals who lease equipment with the intent to purchase and claim investment tax credits. It clarifies that the lessor is considered the original user for investment credit purposes unless an election under section 48(d) is made. Legal practitioners advising clients on tax planning must ensure that if a lessee wishes to claim the investment credit, the lessor makes the necessary election. This ruling also impacts how similar cases involving leased property and tax credits are analyzed, emphasizing the importance of the election process. Subsequent cases, such as those involving changes in tax law, may reference this decision to determine the eligibility of leased property for tax incentives.

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