Bloomberg v. Commissioner, 72 T. C. 398 (1979)

The investment tax credit is not available to a non-corporate lessor if the lease term exceeds 50% of the property's useful life, regardless of subsequent lease modifications.

Summary

In Bloomberg v. Commissioner, the Tax Court ruled that Leroy and Sally Bloomberg were not entitled to an investment tax credit on equipment they leased to their professional corporation because the lease term exceeded 50% of the equipment's useful life. The court rejected the argument that a later termination letter could retroactively shorten the lease term for tax purposes. Additionally, the Bloombergs failed to substantiate the business use of two automobiles, limiting their investment credit to a conceded amount. This case clarifies that the investment tax credit is determined based on circumstances at the time property is first placed in service, and subsequent changes do not retroactively qualify the property for the credit.

Facts

Leroy Bloomberg, an ophthalmologist, and his wife Sally, leased medical equipment and office furniture to their professional corporation, Leroy Bloomberg, M. D. , Inc. , in 1974. The lease was for five years, and the equipment was purchased and first used by the corporation that year. The Bloombergs claimed depreciation on the equipment and reported the lease payments as income. In 1977, the corporation's accountant sent a letter terminating the lease effective immediately and replacing it with a monthly allowance. The Bloombergs also purchased two automobiles in 1974, which they used personally and for business, receiving an allowance from the corporation. They claimed depreciation and investment credits on these vehicles.

Procedural History

The IRS issued a notice of deficiency disallowing the entire investment credit claimed by the Bloombergs. They petitioned the Tax Court, which heard the case and issued its opinion in 1979.

Issue(s)

1. Whether the Bloombergs are entitled to an investment credit under sections 38 and 46 for equipment leased to their professional corporation.
2. Whether the Bloombergs are entitled to an investment credit in excess of $65. 86 for two automobiles they owned and used in their business as employees of the corporation.

Holding

1. No, because the lease term exceeded 50% of the equipment's useful life at the

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time it was first placed in service, and subsequent termination of the lease did not retroactively qualify the equipment for the credit.
2. No, because the Bloombergs failed to substantiate the business use of the automobiles, limiting their credit to the amount conceded by the IRS.

Court's Reasoning

The court applied section 46(e)(3), which limits the investment credit for non-corporate lessors to leases with terms less than 50% of the property's useful life. The court found that the five-year lease term exceeded this threshold based on the depreciation schedules claimed by the Bloombergs. They rejected the argument that the 1977 termination letter could retroactively shorten the lease term, stating that investment credit eligibility is determined based on circumstances at the time the property is first placed in service. The court cited World Airways, Inc. v. Commissioner and Gordon v. Commissioner to support this principle. Regarding the automobiles, the court noted that the Bloombergs provided no evidence of business use, so they were not entitled to depreciation or investment credit beyond what the IRS conceded.

Practical Implications

This decision emphasizes the importance of carefully structuring lease agreements to qualify for investment tax credits. Practitioners must ensure that lease terms meet the statutory requirements at the time property is first placed in service, as subsequent modifications cannot retroactively qualify the property. The case also underscores the need for thorough documentation of business use when claiming credits for personal property. Subsequent cases have applied this principle consistently, reinforcing the need for precise planning in structuring leases and claiming tax credits.

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