James M. Samis and Shirley A. Samis, et al. v. Commissioner of Internal Revenue, 76 T. C. 609 (1981)

A central heating or air conditioning system, even if separately owned and operated, is considered a structural component of a building and does not qualify for investment tax credits or certain depreciation benefits.

Summary

James M. Samis and other petitioners, partners in a limited partnership owning a total energy plant, sought investment tax credits and accelerated depreciation for the plant which provided heating and cooling services to an apartment complex. The Tax Court ruled that the energy plant, despite being separately owned, was an integral part of the apartment complex's heating and air conditioning system and thus classified as a structural component of the building. Therefore, it did not qualify as tangible personal property or other tangible property eligible for investment credits or double declining balance depreciation. This decision emphasizes the importance of the function and permanency of installations in determining their classification for tax purposes.

Facts

In 1972, the petitioners formed a limited partnership, Whispering Hills Energy, Ltd. , to acquire and operate a total energy plant designed to supply heating and cooling water to an apartment complex owned by KF-IDS. The plant consisted of a concrete block structure housing boilers, refrigeration equipment, and related components, as well as buried pipes connecting the plant to the apartments. The partnership claimed investment credits and used the double declining balance method for depreciation. However, the plant was the sole supplier of heating and cooling services to the apartment complex, and the partnership also maintained the entire energy distribution system within the apartments.

Procedural History

The Commissioner of Internal Revenue determined deficiencies in the petitioners' income taxes due to disallowed investment credits and depreciation. The petitioners filed with the U. S. Tax Court, which consolidated the cases and ruled in favor of the Commissioner, denying the claimed tax benefits.

Issue(s)

1. Whether the total energy plant qualifies as tangible personal property or other tangible property eligible for the investment credit under section 38 of the Internal Revenue Code.
2. Whether the total energy plant is section 1250 property, thereby limiting depreciation under the declining balance method to 150 percent of the straight line rate.

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3. Whether the total energy plant qualifies as tangible personal property eligible for the additional first year depreciation allowance under section 179 of the Internal Revenue Code.

Holding

1. No, because the total energy plant was considered a structural component of the KF-IDS apartment complex, it did not qualify as tangible personal property or other tangible property for the investment credit.
2. Yes, because the total energy plant was classified as section 1250 property, the allowable depreciation under the declining balance method was limited to 150 percent of the straight line rate.
3. No, because the total energy plant was a structural component of a building, it did not qualify as tangible personal property for the additional first year depreciation allowance.

Court's Reasoning

The court applied the definitions from the Income Tax Regulations to determine that the concrete block structure housing the energy plant's equipment was a building and not a special-purpose structure eligible for investment credits. The court also found that the entire energy plant was an integral part of the apartment complex's heating and air conditioning system, thus classifying it as a structural component of the building. This classification was based on the plant's function as an essential service provider to the apartments and its permanency, as evidenced by the long-term contract and KF-IDS's option to purchase the plant. The court cited previous cases and Revenue Rulings to support its interpretation of the regulations. The court's decision was influenced by the policy of ensuring that tax benefits align with the intended purposes of the investment credit and depreciation allowances, which aim to encourage investment in certain types of property.

Practical Implications

This decision has significant implications for how energy facilities and similar installations are treated for tax purposes. It establishes that even separately owned facilities that serve a single building or complex as part of its central heating or air conditioning system will be considered structural components, thereby ineligible for investment tax credits and certain accelerated depreciation methods. Legal practitioners must carefully analyze the function and permanency of installations when advising clients on tax benefits. Businesses should consider the tax implications of structuring their energy supply arrangements, especially in real estate development. Subsequent cases have continued to apply this principle, often citing Samis v. Commissioner when determining the eligibility of property for tax benefits.

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