Carlson v. Commissioner, 79 T. C. 215 (1982)

A noncorporate lessor cannot claim an investment tax credit unless they manufacture or produce the leased property in the ordinary course of their business.

Summary

In Carlson v. Commissioner, the Tax Court ruled that Laurence M. Carlson, who leased apple-picking bins to Welch Apples, Inc. , was not entitled to an investment tax credit under Section 46(e)(3)(A) of the Internal Revenue Code. The key issue was whether Carlson had manufactured the bins in the ordinary course of his business. The court found that Carlson did not personally assemble the bins nor control the details of their assembly, which was carried out by workmen selected by Welch Apples' manager. The court emphasized that mere payment of assembly costs does not constitute manufacturing, and thus, Carlson was ineligible for the credit.

Facts

Laurence M. Carlson, a lawyer, leased apple-picking bins to Welch Apples, Inc. , where he also served as the attorney. The bins were ordered in a partly assembled condition from H. R. Spinner Co. by Welch Apples' general manager, Reed Johnston. Workmen selected by Reed completed the assembly of the bins at Welch Apples' location. Carlson reimbursed Welch Apples for these assembly costs but did not personally assemble the bins or provide any instructions to the workmen. The leases were for seven years each, and Carlson claimed investment tax credits for the bins on his tax returns for the years 1974, 1975, and 1976.

Procedural History

The Commissioner of Internal Revenue disallowed the investment tax credits claimed by Carlson, leading to a deficiency determination. Carlson petitioned the Tax Court for a redetermination of the deficiency. The Tax Court upheld the Commissioner's decision, ruling against Carlson's entitlement to the investment tax credits.

Issue(s)

1. Whether Laurence M. Carlson is entitled to the investment tax credit provided by Section 38 of the Internal Revenue Code for the apple-picking bins he leased to Welch Apples, Inc. , under Section 46(e)(3)(A).

Holding

1. No, because Carlson did not manufacture or produce the bins in the ordinary course of his business, as required by Section 46(e)(3)(A). He merely financed the assembly of the bins without engaging in the manufacturing process or controlling its details.

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Court’s Reasoning

The Tax Court’s decision hinged on the interpretation of Section 46(e)(3)(A), which requires noncorporate lessors to have manufactured or produced the leased property in the ordinary course of their business to be eligible for the investment tax credit. The court emphasized that “manufactured by the lessor” implies direct involvement in the manufacturing process or control over its details. Carlson did not personally assemble the bins, nor did he provide instructions or supervise the assembly process. The workmen were selected by Welch Apples’ manager and worked at their facility, further distancing Carlson from the manufacturing process. The court cited legislative history and case law to support its interpretation that mere financing of manufacturing costs does not satisfy the statutory requirement. The court also rejected Carlson’s argument that his business reasons for leasing justified an exception, noting that the statute’s language is unambiguous and does not provide for such exceptions.

Practical Implications

This decision clarifies that noncorporate lessors must be directly involved in the manufacturing process to claim investment tax credits under Section 46(e)(3)(A). Legal practitioners advising noncorporate clients on leasing arrangements should ensure that their clients are actively engaged in the production or assembly of the leased property to qualify for such credits. The ruling may discourage noncorporate entities from entering into leasing arrangements solely for tax benefits without substantive involvement in the production process. Subsequent cases have cited Carlson v. Commissioner to reinforce the requirement of active manufacturing involvement for noncorporate lessors seeking investment tax credits.

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