Grow v. Commissioner, 80 T. C. 314 (1983)

Investment tax credit can be claimed on the unused portion of a utility system when the property is split between new and used elements.

Summary

In Grow v. Commissioner, the Tax Court addressed whether a partnership could claim an investment tax credit for a water and sewer system in a mobile home park. The system was partially used by the seller before the partnership's purchase. The Court held that the system qualified as Section 38 property because the partnership operated it as a separate business with the intent to profit. The Court further ruled that the system could be divided into new and used portions based on the ratio of occupied to unoccupied sites at the time of purchase. However, the used portion was ineligible for the credit due to a lease-back arrangement with the seller.

Facts

In 1975, a partnership purchased the Majestic Oaks Mobile Home Park, which included a water and sewer system. At the time of purchase, 82 of 398 mobile home sites were rented by the seller, M & H Investment. The partnership leased the park back to M & H Investment until a certain occupancy level was reached. After the lease ended in 1976, the partnership managed the park and treated the utility system as a separate business, aiming to generate profit from both the park and the utility services.

Procedural History

The partnership claimed an investment tax credit for the water and sewer system on its 1975 tax return. The Commissioner disallowed the credit, leading to deficiencies for the partners. The cases were consolidated for trial, briefing, and opinion in the U. S. Tax Court, which held that the partnership was entitled to the credit on the new portion of the system but not on the used portion due to the lease-back arrangement.

Issue(s)

1. Whether the water and sewer system qualifies as Section 38 property under Section 48(a)?
2. If the system qualifies, whether it is new or used within the meaning of Section 48(b) and (c)?
3. If used, whether the investment tax credit is barred under Section 48(c)?

Holding

1. Yes, because the partnership operated the water and sewer system as a separate business with the intent to profit.

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2. The system is both new and used; 82/398 was used and 316/398 was new based on the occupancy at purchase.
3. No, because the used portion of the system is ineligible for the credit due to the lease-back arrangement with M & H Investment.

Court’s Reasoning

The Court determined that the water and sewer system qualified as Section 38 property because the partnership operated it as a separate business, evidenced by separate accounting and a profit motive. The Court applied the test from Evans v. Commissioner, requiring substantial income and good-faith intent to profit. The system was divided into new and used portions based on the proportion of occupied sites at purchase. The used portion was ineligible for the credit due to Section 48(c)’s prohibition on claiming credit for property used by the same person before and after acquisition. The Court emphasized the importance of a liberal construction of the investment tax credit provisions and rejected the petitioners’ claim of surprise regarding the application of Section 48(c).

Practical Implications

This decision clarifies that investment tax credits can be claimed on the unused portion of partially used property when it can be reasonably divided. It emphasizes the need for clear separation of business operations to qualify for such credits. Practitioners should carefully analyze the status of acquired property as new or used and be aware of lease-back arrangements that can affect credit eligibility. The ruling may encourage businesses to structure utility services as separate profit centers to maximize tax benefits. Subsequent cases like Kansas City Southern Railway Co. v. Commissioner have applied similar principles to the division of property for tax purposes.

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