McKenzie v. Commissioner, 85 T. C. 875 (1985)

The investment tax credit does not apply to structures used for non-agricultural or non-food production activities, nor to general purpose structures that can be economically used for other purposes.

Summary

In McKenzie v. Commissioner, the petitioners claimed investment tax credits for a dog and cat kennel and a horse barn, arguing these were single purpose agricultural structures. The U. S. Tax Court held that neither qualified for the credit: the kennel was not used for agricultural or food production, and the horse barn was a general purpose structure. The court clarified that for a structure to qualify as "section 38 property," it must be specifically designed, constructed, and used for agricultural or food production activities, and horses do not count as livestock for these purposes. This decision underscores the narrow scope of the investment tax credit for agricultural structures and the importance of the structure's specific design and use.

Facts

Jerrold and Sally McKenzie purchased a property that included a dog and cat kennel and a horse barn. They claimed investment tax credits for these structures, asserting they were single purpose agricultural or horticultural structures. The kennel was designed for temporary boarding of pets, with specific sanitation and comfort features. The horse barn was a general purpose "Lester" building, modified by the McKenzies for their Arabian horse activities. The McKenzies also made subsequent improvements to the barn.

Procedural History

The McKenzies filed their tax returns for 1973 and 1976, claiming investment tax credits for the kennel and horse barn. After the IRS denied these claims, the McKenzies filed amended returns and a petition in the U. S. Tax Court challenging the IRS's disallowance of the credits.

Issue(s)

1. Whether the McKenzies' dog and cat kennel qualifies as a single purpose agricultural or horticultural structure under section 48(a)(1)(D)?
2. If not, whether the boarding area of the kennel is tangible personal property under section 48(a)(1)(A)?
3. Whether the McKenzies' horse barn qualifies as a single purpose agricultural or horticultural structure under section 48(a)(1)(D)?
4. Whether horses are considered livestock under section 48(p)(2)?

Holding

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1. No, because the kennel was not used for agricultural or food production activities.
2. No, because the boarding area is an inherently permanent structure and not tangible personal property.
3. No, because the horse barn is a general purpose structure that can be economically used for other purposes.
4. No, because horses are not considered livestock under the applicable regulations.

Court’s Reasoning

The court analyzed the statutory language of section 48 and the legislative history, emphasizing that the investment tax credit for agricultural structures was intended for those used in agricultural or food production activities. The kennel, used for temporary boarding of household pets, did not meet this criterion. The court also applied the regulations defining tangible personal property, determining that the kennel’s boarding area was an inherently permanent structure and thus ineligible. For the horse barn, the court found that it was not specifically designed and constructed for a single purpose related to livestock, as it was a general purpose building capable of other uses. Additionally, the court upheld the regulation excluding horses from the definition of livestock, finding it consistent with the statute’s intent.

Practical Implications

This decision limits the scope of the investment tax credit to structures specifically designed and used for agricultural or food production, excluding those used for non-agricultural purposes like pet boarding. It also clarifies that general purpose structures do not qualify, even if modified for a specific use. Taxpayers and practitioners must carefully consider the design, construction, and use of structures when claiming investment tax credits. The ruling may affect how similar claims are evaluated in future cases, emphasizing the need for structures to be narrowly tailored to qualifying activities. Subsequent cases have distinguished this ruling when structures are more directly involved in agricultural production processes.

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