Miller v. Commissioner, 84 T. C. 820 (1985)

Noncorporate lessors are entitled to investment tax credits if a lease meets the statutory tests of being less than 50% of the property's useful life and incurs expenses exceeding 15% of lease payments in the first year.

Summary

In Miller v. Commissioner, the Tax Court ruled that noncorporate lessors could claim investment tax credits for a crane leased to a related corporation, provided the lease met specific statutory criteria. The court found that the lease term was less than 50% of the crane's useful life, and the lessor's expenses exceeded 15% of the lease payments in the first year. The decision emphasized the objective nature of these tests, rejecting the IRS's argument that a separate trade or business requirement must be met. The ruling clarified that satisfying these objective tests was sufficient for eligibility, impacting how noncorporate lessors structure leases to qualify for tax benefits.

Facts

In 1979, petitioners formed the 850 Company, a partnership, and purchased a crane using a full recourse loan. They leased the crane to Miller Compressing Co. , Inc. , a closely held corporation in which they were shareholders, for a term of 7 years and 5 months, which was less than 50% of the crane's useful life. The lease required the partnership to cover maintenance, repair, and insurance expenses during the first 12 months, which exceeded 15% of the lease payments. The partnership anticipated profitability based on projections, but actual profitability was affected by rising interest rates.

Procedural History

The IRS issued notices of deficiency to the petitioners, disallowing their claims for investment tax credits related to the crane lease. The petitioners challenged this in the U. S. Tax Court, which heard the case without a trial based on stipulated facts. The court's decision focused on the interpretation of the statutory requirements for noncorporate lessors to claim investment tax credits.

Issue(s)

1. Whether the lease of the crane to Miller Compressing Co. , Inc. by the 850 Company partnership qualifies for investment tax credits under section 46(e)(3)(B) of the Internal Revenue Code.
2. Whether the partnership must be engaged in the trade or business of leasing beyond meeting the statutory tests to qualify for the credits.

Holding

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1. Yes, because the lease met both the 50-percent useful life test and the 15-percent expense test as required by section 46(e)(3)(B).
2. No, because the statute does not impose an additional trade or business requirement beyond the objective tests.

Court's Reasoning

The court interpreted section 46(e)(3)(B) to require only that the lease term be less than 50% of the property's useful life and that the lessor incur expenses exceeding 15% of lease payments in the first year. The court rejected the IRS's argument for an additional trade or business test, citing the legislative history that intended these objective tests to determine when a lease constitutes a business activity. The court noted that the calculation of the 15-percent expense test focused solely on the lease in question, supporting the conclusion that no broader trade or business test was intended. The court also found that the lease was not a sham, as it was negotiated at arm's length and had economic substance. The court referenced prior cases to support the notion that leasing a single piece of equipment can constitute a trade or business.

Practical Implications

This decision provides clarity for noncorporate lessors on how to structure leases to qualify for investment tax credits. It emphasizes the importance of meeting the statutory tests and suggests that such leases can be considered part of a trade or business even if they involve leasing only one piece of equipment. Practitioners should advise clients to ensure leases meet these objective criteria, as this will be sufficient for credit eligibility. The ruling may encourage more noncorporate entities to engage in leasing activities to take advantage of tax benefits, potentially affecting how businesses structure their operations. Subsequent cases have applied this ruling, further refining the application of investment tax credits to noncorporate lessors.

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