Miller v. Commissioner, 85 T.C. 1064 (1985)

For noncorporate lessors to qualify for an investment tax credit under I.R.C. § 46(e)(3)(B), they must satisfy two objective tests: the lease term is less than 50% of the property's useful life, and the lessor's expenses during the first 12 months exceed 15% of the gross rental income; no additional 'trade or business' test is required beyond these objective criteria.

Summary

Petitioners, partners in a general partnership, purchased a crane with recourse financing and leased it to their closely held corporation. The partnership incurred maintenance and repair expenses exceeding 15% of the lease payments within the first 12 months. The Tax Court addressed whether the partnership, as a noncorporate lessor, was entitled to an investment tax credit. The court held that meeting the two statutory tests of lease term length and expense percentage is sufficient for the investment tax credit, and the IRS cannot impose an additional 'trade or business' test. The petitioners were thus entitled to the investment tax credit.

Facts

Petitioners formed a partnership and obtained a recourse loan to purchase a crane.

The partnership leased the crane to Miller Compressing Co., Inc., a corporation closely held by the partners, for a term less than 50% of the crane's useful life.

The lease stipulated that the partnership would cover operating and maintenance expenses for the first 12 months, up to 16% of the first year's lease payments; actual expenses exceeded 15%.

The IRS challenged the petitioners' claim for investment tax credits, arguing that the partnership was not genuinely engaged in the trade or business of leasing.

Procedural History

The Commissioner of Internal Revenue issued notices of deficiency disallowing investment tax credits claimed by the petitioners.

Petitioners challenged the deficiency determination in the United States Tax Court.

The case was submitted to the Tax Court without trial based on stipulated facts.

Issue(s)

1. Whether noncorporate lessors must demonstrate they are engaged in a trade or business of leasing, beyond meeting the two objective tests in I.R.C. § 46(e)(3)(B), to

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qualify for investment tax credits.

Holding

1. No. The Tax Court held that meeting the two objective tests in I.R.C. § 46(e)(3)(B) – the lease term being less than 50% of the property's useful life and the lessor's expenses exceeding 15% of rental income in the first year – is sufficient for noncorporate lessors to qualify for the investment tax credit. No additional trade or business test is required because Congress intended these objective tests to define 'business activity' for the purpose of the credit.

Court's Reasoning

The court analyzed the language of I.R.C. § 46(e)(3)(B) and its legislative history.

The statute sets forth two specific, objective tests: the 50% useful life test and the 15% expense test. The petitioners met both.

The legislative history indicates that these tests were designed to distinguish between genuine business leasing activities and passive investments. The House Report stated that short-term leases are considered "business activity of the taxpayer, rather than a mere investment."

The court reasoned that if Congress intended an additional 'trade or business' test, it would have explicitly stated so. The reference to "section 162 expenses" in § 46(e)(3)(B) merely specifies the type of expenses to be considered for the 15% test, not to impose a separate trade or business requirement.

The court quoted *Ridder v. Commissioner*, 76 T.C. 867, 876 (1981), emphasizing that Congress chose "two hard-and-fast tests" for administrative ease and predictability.

The court rejected the IRS's argument that the lease lacked economic substance, finding that the partnership secured a recourse loan, anticipated profit, and the lease provided economic benefit to the corporation. The court stated, "We cannot agree with respondent's assertion, however, that the lease under consideration herein was lacking in economic substance or business purpose."

Even if a separate trade or business test were required, the court found the partnership met it through the active management and expenses associated with the crane lease.

Practical Implications

Miller v. Commissioner clarifies that noncorporate lessors seeking investment tax credits for leased property primarily need to satisfy the objective criteria of I.R.C. § 46(e)(3)(B).

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Taxpayers can rely on meeting the 50% lease term and 15% expense tests without needing to prove a separate ‘trade or business’ of leasing for short-term leases.

This case provides a predictable and administrable standard for investment tax credits in leasing contexts, reducing ambiguity and potential disputes with the IRS.

Subsequent cases and IRS rulings should interpret § 46(e)(3)(B) based on these objective tests, focusing less on subjective ‘trade or business’ inquiries for short-term leases meeting the statutory thresholds.

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