Egizii v. Commissioner, 86 T. C. 450 (1986)

Noncorporate lessors must manufacture or produce the leased property to claim investment tax credits under IRC section 38.

Summary

John and Helen Egizii sought investment tax credits for a refrigeration unit, extra cooler equipment, and office carpet installed in a warehouse they leased to their controlled corporation, E & F Distributing Co. The Tax Court held that the Egiziis did not manufacture or produce the leased property, as required by IRC section 46(e)(3)(A), and thus were not eligible for the credits. The court emphasized that the property subject to the lease for credit purposes was the specific leased items, not the entire warehouse. The Egiziis' limited supervisory role in the warehouse construction did not constitute manufacturing or production of the leased property.

Facts

John E. Egizii, involved in the alcoholic beverage wholesale business since 1945, incorporated his business as E & F Distributing Co. in 1960. In 1977, Miller Brewing Co. required E & F to build a new warehouse to retain its distributorship. The Egiziis financed the construction, hiring Evans Construction Co. to build the warehouse. The refrigeration unit, extra cooler equipment, and office carpet, which were installed per Miller's specifications, were obtained from third parties. The Egiziis did not engage in the physical construction but conducted weekly inspections and progress payments. In 1978, the Egiziis leased the completed warehouse to E & F and claimed investment tax credits for the refrigeration equipment and office carpet on their tax return.

Procedural History

The Commissioner of Internal Revenue determined a deficiency in the Egiziis' 1978 federal income tax and denied their investment tax credit claim. The Egiziis petitioned the U. S. Tax Court, which heard the case without trial under Rule 122. The court's decision was entered for the respondent, denying the investment tax credit to the Egiziis.

Issue(s)

1. Whether the property subject to the lease for the purpose of claiming the investment tax credit under IRC section 46(e)(3)(A) includes the entire property leased (the warehouse) or only the specific items for which the credit is sought (the refrigeration unit, extra cooler equipment, and office carpet)?

2. Whether the Egiziis manufactured or produced the refrigeration unit, extra cooler equipment, and office carpet to qualify for the investment tax credit?

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Holding

1. No, because the term “property subject to the lease” in IRC section 46(e)(3)(A) refers to the specific items for which the credit is sought, not the entire leased property.

2. No, because the Egiziis did not manufacture or produce the refrigeration unit, extra cooler equipment, and office carpet; their involvement was limited to supervisory oversight, which was insufficient to meet the statutory requirement.

Court’s Reasoning

The court interpreted IRC section 46(e)(3)(A) to require that the specific leased items for which the credit is sought must be manufactured or produced by the noncorporate lessor. The court rejected the Egiziis’ argument that their supervision of the entire warehouse construction satisfied this requirement. The court applied the factors from Carlson v. Commissioner, which include provision of specifications and control over the details of manufacture. The Egiziis did not provide the specifications for the leased items, as these were set by Miller, and they did not control the details of their construction, as this was managed by the contractor, Evans. The court concluded that the Egiziis’ role did not rise to the level of manufacturing or production required by the statute.

Practical Implications

This decision clarifies that noncorporate lessors seeking investment tax credits under IRC section 38 must have directly manufactured or produced the specific leased property. It establishes that overseeing the construction of a larger project, like a building, does not suffice if the leased items are components within that project. Practitioners advising clients on investment tax credits must ensure their clients meet the manufacturing or production requirement for the exact property leased. This case may deter noncorporate lessors from attempting to claim credits for leased property they did not directly manufacture or produce. Subsequent cases, such as Carlson v. Commissioner, have applied similar reasoning to uphold the requirement for direct involvement in the production process.

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