Borgic v. Commissioner, 86 T. C. 643 (1986)

Transferring assets to a corporation can be considered a mere change in the form of conducting a business, avoiding investment tax credit recapture, if the assets remain used in the same trade or business.

Summary

Erval and Betty Borgic incorporated their farm operation in 1974 but retained ownership of certain farm equipment, leasing it to their corporation, Borgic Farms, Inc. In 1979, they transferred the equipment to the corporation after an Illinois personal property tax was abolished. The IRS sought to recapture the investment tax credits the Borgics had claimed on the equipment, arguing the transfer constituted a disposition triggering recapture. The Tax Court held that the transfer was a mere change in the form of conducting the farming business, thus not subject to recapture, because the equipment was always used for farming, and the Borgics remained farmers, despite the corporate structure.

Facts

Erval and Betty Borgic operated a farm as a sole proprietorship until November 15, 1974, when they incorporated as Borgic Farms, Inc. They transferred grain and livestock inventories to the corporation but retained ownership of farm equipment, leasing it to the corporation due to an Illinois personal property tax on corporate assets. They claimed investment tax credits on the equipment. In 1979, after the tax was abolished, they transferred the equipment to the corporation in exchange for stock and debentures. The IRS determined a deficiency of $12,765. 04, asserting the transfer triggered recapture of the investment credits.

Procedural History

The Borgics petitioned the Tax Court for a redetermination of the deficiency. The case was submitted without trial pursuant to Rule 122, with stipulated facts. The Tax Court considered whether the transfer of the farm equipment to the corporation constituted a disposition subject to investment tax credit recapture under Section 47(a)(1) of the Internal Revenue Code, or whether it fell under the exception in Section 47(b) as a mere change in the form of conducting a trade or business.

Issue(s)

1. Whether the transfer of farm equipment from the Borgics to their wholly owned corporation constituted a mere change in the form of conducting a trade or business under Section 47(b) of the Internal Revenue Code, thus avoiding investment tax credit recapture.

Holding

1. Yes, because the farm equipment was always used in the farming business, and the Borgics remained farmers despite the corporate structure, the transfer was a mere change in the form of conducting the business, and no recapture of investment tax credits was required.

Court's Reasoning

The court applied the criteria in Section 1. 47-3(f)(1)(ii) of the Income Tax Regulations, which require that the transferred property be retained as Section 38 property in the same trade or business, the transferor retains a substantial interest in the business, substantially all assets necessary for the business are transferred, and the basis of the property in the transferee's hands is determined by reference to the transferor's basis. The IRS conceded that the latter three criteria were met, leaving the issue of whether the equipment was used in the same trade or business. The court found that the Borgics were farmers, not lessors, and the equipment was always used in farming, even though it was leased to the corporation. The court emphasized the substance over form, noting that the Borgics' leasing activities were passive and did not rise to the level of a separate trade or business. The court also referenced legislative history indicating that the recapture rules were intended to prevent quick turnovers of assets for multiple tax credits, which was not the case here as the corporation could not take investment credits on the transferred equipment.

Practical Implications

This decision provides guidance on structuring business transitions to avoid unintended tax consequences. It emphasizes that the substance of the business activity, rather than its legal form, determines whether a transfer of assets is subject to investment tax credit recapture. Taxpayers can incorporate their businesses and transfer assets without triggering recapture if the assets continue to be used in the same trade or business. This ruling may influence how farmers and other business owners structure their operations to minimize tax liabilities when transitioning to corporate form. Subsequent cases have applied this ruling to similar situations involving the transfer of business assets to corporations, focusing on the continuity of business use rather than the form of ownership.