## *De Marco v. Commissioner, 87 T. C. 518 (1986)*

To claim a rehabilitation tax credit, taxpayers must elect the straight-line method of depreciation for the rehabilitated property on their original tax return for the year the property is placed in service.

### Summary

In De Marco v. Commissioner, the taxpayers sought a rehabilitation tax credit for improvements made to a factory building in 1982 but failed to elect the required straight-line method of depreciation on their original tax return. Instead, they initially omitted the improvements and later used an accelerated method on an amended return. The Tax Court held that the taxpayers were ineligible for the credit because the election must be made on the original return for the taxable year concerned, not on an amended return. This case underscores the necessity of clear and timely elections to claim tax benefits and highlights the complexities of tax law that can lead to forfeiture of credits if not followed precisely.

### Facts

In 1973, Frank and Jacquelyn DeMarco purchased and placed into service a factory building in Everett, Massachusetts, which they leased to Middlesex Manufacturing Co. In 1982, they completed $360,294 in improvements to the building. On their original 1982 tax return, the DeMarcos did not account for these improvements. Later, on an amended return filed in September 1983, they claimed depreciation for the improvements using the accelerated method under section 168(b)(1) of the Internal Revenue Code and also claimed a 20% rehabilitation credit under section 38. The Commissioner disallowed the credit, asserting that the DeMarcos did not make the necessary election to use straight-line depreciation.

### Procedural History

The Commissioner determined a deficiency in the DeMarcos' 1982 income tax and disallowed their rehabilitation credit claim. The DeMarcos petitioned the U. S. Tax Court, which reviewed the case on a fully stipulated record. The Tax Court upheld the Commissioner's determination, ruling that the DeMarcos were ineligible for the rehabilitation credit because they did not elect the straight-line method of depreciation on their original 1982 tax return.

### Issue(s)

1. Whether the DeMarcos were entitled to a rehabilitation tax credit under section 38 of the Internal Revenue Code for the improvements made to their building in 1982.

### Holding

 

1. No, because the DeMarcos did not elect to use the straight-line method of depreciation for the improvements on their original 1982 tax return, as required by sections 48(g)(2)(B) and 168(b)(3) of the Internal Revenue Code.

## Court's Reasoning

The Tax Court's decision hinged on the statutory requirement that the election to use straight-line depreciation, which is necessary for claiming the rehabilitation credit, must be made on the taxpayer's return for the taxable year in which the property is placed in service. The court emphasized that the DeMarcos' original 1982 return did not mention the improvements at all, and their later amended return used an accelerated method of depreciation, which did not satisfy the election requirement. The court noted that the legislative intent behind the election requirement was to ensure taxpayers choose between accelerated depreciation and the rehabilitation credit. The court also declined to address whether an election could be made on an amended return, as the DeMarcos had not made such an election on their amended return either. The court's decision was influenced by the complexity of the tax code, which it criticized for being difficult to navigate even for those experienced in tax matters.

## Practical Implications

This decision emphasizes the importance of adhering strictly to the procedural requirements of the tax code, particularly regarding elections for tax benefits. Practitioners must ensure that clients make all necessary elections on their original tax returns, as subsequent amendments may not suffice. This ruling impacts how similar cases are analyzed, requiring attorneys to scrutinize the timing and method of depreciation elections. It also highlights the potential pitfalls in tax planning, where failure to make the correct election can result in the loss of significant tax credits. The decision has broader implications for business planning, as companies considering rehabilitation projects must carefully plan their tax strategies to maximize available credits. Subsequent cases have similarly focused on the strict interpretation of election requirements under the tax code.

 