

Richard G. Cooper and June A. Cooper, et al. , Petitioners v. Commissioner of Internal Revenue, Respondent, 88 T. C. 84; 1987 U. S. Tax Ct. LEXIS 6; 88 T. C. No. 6

Taxpayers may claim tax benefits for solar equipment leases if they have a profit motive, the equipment is placed in service, and the at-risk rules are satisfied.

Summary

Richard G. Cooper and other petitioners purchased solar water heating systems from A. T. Bliss & Co. on a leveraged basis and leased them to Coordinated Marketing Programs, Inc. The Tax Court held that the transactions were not shams, and petitioners were entitled to tax benefits, including depreciation and investment tax credits, as they had a bona fide profit motive. The court determined that the equipment was placed in service upon purchase, but the at-risk rules limited deductions to the cash investment due to nonrecourse financing and put options.

Facts

In 1979 and 1980, petitioners purchased solar water heating systems from A. T. Bliss & Co. for either \$100,000 (full lot of 27 systems) or \$50,000 (half lot of 13 systems). The systems were immediately leased to Coordinated Marketing Programs, Inc. for 7 years at \$19.25 per system per month. Petitioners also entered into maintenance agreements with Alternative Energy Maintenance, Inc. and accounting agreements with Delta Accounting Services. A. T. Bliss guaranteed Coordinated's obligations under the leases, and petitioners had a put option to require Coordinated to purchase the systems at lease-end for an amount equal to the outstanding balance on their notes to A. T. Bliss.

Procedural History

The Commissioner of Internal Revenue disallowed the deductions and credits claimed by petitioners, asserting that the transactions were shams and that petitioners did not acquire ownership of the systems. The cases were consolidated and heard by the U. S. Tax Court, which found that the transactions were bona fide and allowed the tax benefits, subject to limitations under the at-risk rules.

Issue(s)

1. Whether the transactions between petitioners and A. T. Bliss were shams and should be disregarded for tax purposes.
2. Whether petitioners acquired ownership of the solar water heating systems.
3. Whether petitioners had a bona fide profit motive in entering into the transactions.
4. Whether the systems were placed in service in the year of purchase for purposes of depreciation and tax credits.
5. Whether the at-risk rules of section 465 limit petitioners' allowable deductions.

Holding

1. No, because the transactions were genuine multi-party transactions, and legal title and profits from the systems passed to petitioners.
2. Yes, because petitioners acquired legal title, profits, and the burden of maintenance, and the leases with Coordinated did not divest them of ownership.
3. Yes, because petitioners entered the transactions with a bona fide objective to make a profit, evidenced by their businesslike approach and expectation of future income from rising energy prices.
4. Yes, because the systems were placed in service upon purchase when they were held out for lease to Coordinated.
5. Yes, because nonrecourse financing and put options limited petitioners' at-risk amounts to their cash investments.

Court's Reasoning

The court applied the substance-over-form doctrine to determine that the transactions were not shams, as petitioners acquired legal title and profits from the systems. The court used factors from *Grodt & McKay Realty, Inc. v. Commissioner* to find that petitioners owned the systems, rejecting the Commissioner's argument that the leases with Coordinated were disguised sales. The court found a bona fide profit motive based on the factors in section 1.183-2(b) of the Income Tax Regulations, including the businesslike manner of the transactions and the expectation of future profits. The court also held that the systems were placed in service upon purchase, following *Waddell v. Commissioner*, and that the at-risk rules limited deductions due to nonrecourse financing and put options.

Practical Implications

This decision provides guidance on the tax treatment of leased equipment, particularly in the context of energy-efficient technology. Tax practitioners should ensure that clients have a bona fide profit motive when entering into similar transactions to claim tax benefits. The ruling clarifies that equipment can be considered placed in service when held out for lease, which is significant for depreciation and tax credit calculations. The at-risk rules remain a critical consideration, limiting deductions to cash investments when nonrecourse financing and protective put options are used. Subsequent cases, such as *Estate of Thomas v. Commissioner*, have further developed the application of these principles.