Kerry v. Commissioner, 88 T. C. 102 (1987)

A late election to pass through an investment tax credit from a lessor to a lessee under section 48(d) will not be allowed when the statutory and regulatory requirements for such an election are not met.

Summary

The Kerry brothers, who operated Kerry Coal Co. and Kerry Bros. partnership, sought to make a late election to pass through investment tax credits from the partnership to the corporation after initially claiming the credits impermissibly. The Tax Court ruled that a late election under section 48(d) was not permissible, emphasizing strict adherence to the statutory and regulatory requirements. The court distinguished this case from previous rulings allowing late elections under different tax provisions, highlighting the unique complexities and administrative burdens of section 48(d) elections. This decision underscores the importance of timely compliance with tax election procedures and the limited applicability of the substantial compliance doctrine in such contexts.

Facts

Vernon and Gail Kerry formed Kerry Bros. , a partnership, to hold equipment used by their S corporation, Kerry Coal Co. , in its mining operations. Kerry Bros. purchased and leased equipment to Kerry Coal during 1974-1976. Initially, Kerry Bros. claimed investment tax credits on its returns, which was impermissible for noncorporate lessors. After an audit, the Kerrys attempted to make a late section 48(d) election to pass the credits to Kerry Coal, filing amended returns in 1978. The IRS disallowed the credits, leading to the court case.

Procedural History

The IRS determined deficiencies in the Kerrys' tax returns for 1974-1977. After the Kerrys conceded the impermissibility of claiming credits through the partnership, they filed amended returns in 1978 attempting a late section 48(d) election. The Tax Court heard the case and ruled on the permissibility of the late election.

Issue(s)

1. Whether Kerry Bros. is entitled to make a late section 48(d) election for the years 1974, 1975, and 1976, to pass the investment tax credit to Kerry Coal Co.
2. Whether the substantial compliance doctrine applies to allow a late section 48(d) election.
3. Whether an extension of time for making the election should be granted under section 1. 9100-1.

Holding

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1. No, because section 48(d) and its regulations require timely elections, and the administrative burdens of allowing a late election are significant.
2. No, because the substantial compliance doctrine does not apply when the essence of the statute is violated by failing to pass the credit to the lessee.
3. No, because the Kerrys failed to formally request an extension and did not meet the regulatory requirements for such a request.

Court’s Reasoning

The court focused on the strict requirements of section 48(d) and its implementing regulations, which necessitate timely elections to coordinate the tax positions of multiple parties. The court distinguished this case from Mamula v. Commissioner, noting that section 48(d) involves more complex administrative issues than the installment sale provisions at issue in Mamula. The court rejected the application of the substantial compliance doctrine, emphasizing that Kerry Bros. retained the credit rather than passing it to Kerry Coal, thus violating the statute’s essence. Finally, the court found that the Kerrys did not properly request an extension under section 1. 9100-1, lacking due diligence in their tax planning.

Practical Implications

This decision reinforces the importance of adhering to statutory and regulatory deadlines for tax elections, particularly in complex situations involving multiple parties. Taxpayers must carefully plan their tax positions and cannot rely on late elections to correct initial errors. Practitioners should advise clients to consider all potential tax implications when structuring business entities and transactions. The ruling may affect how businesses approach leasing arrangements and investment tax credit planning, emphasizing the need for timely and proper elections. Subsequent cases have generally upheld this strict interpretation of section 48(d) requirements.

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