Sauey v. Commissioner, 90 T. C. 824 (1988)

A noncorporate lessor may be entitled to an investment credit if the lease term is less than 50% of the property's useful life and other conditions are met.

Summary

In Sauey v. Commissioner, the U. S. Tax Court ruled that Norman O. Sauey, Jr. , a noncorporate lessor, was eligible for an investment credit under Section 38 of the Internal Revenue Code for leasing an airplane to a related corporation. The key issue was whether the 1981 lease satisfied the 50% requirement of Section 46(e)(3)(B), which stipulates that the lease term must be less than 50% of the property's useful life. The court found that the lease's stated two-year term, which was less than 50% of the airplane's six-year useful life, should be respected as it was not reasonably certain at the lease's inception that it would be extended beyond the stated term. Additionally, the court rejected the aggregation of successive leases of different airplanes under Section 1. 46-4(d)(4) of the Income Tax Regulations.

Facts

Norman O. Sauey, Jr. , leased a 1977 Beechcraft King Air E90 airplane to Portage Industries Corp. in 1976. In 1979, he entered into another three-year lease for the same airplane. In 1981, Sauey terminated the 1979 lease, traded in the old airplane, and purchased a new 1981 Beechcraft King Air B200 airplane with a six-year useful life. On September 11, 1981, he leased the new airplane to Portage Industries Corp. for a two-year term without an option to renew. In January 1983, Sauey terminated the 1981 lease and leased the airplane to Profile Industries Corp. , another related entity, for two years. The Commissioner of Internal Revenue disallowed the investment credit Sauey claimed for the new airplane, prompting the appeal to the Tax Court.

Procedural History

The Commissioner of Internal Revenue issued a notice of deficiency to Sauey for the tax year 1981, disallowing the claimed investment credit. Sauey and his wife, Carla M. Sauey, filed a petition with the U. S. Tax Court. The case was fully stipulated and submitted under Rule 122. The Tax Court, with Chief Judge Sterrett presiding, issued an opinion on May 2, 1988, and as amended on May 16, 1988, finding in favor of the Saueys.

Issue(s)

1. Whether the 1981 lease of the airplane satisfied the 50% requirement of Section 46(e)(3)(B), which requires the lease term to be less than 50% of the property's useful life.

2. Whether the leases of the old and new airplanes should be aggregated under

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Section 1. 46-4(d)(4) of the Income Tax Regulations, treating them as one lease for the purpose of Section 46(e)(3)(B).

Holding

1. Yes, because the 1981 lease had a stated term of two years, which was less than 50% of the airplane's six-year useful life, and there was no evidence that the lease term was actually indefinite.

2. No, because the leases were negotiated and entered into consecutively rather than simultaneously, and the old and new airplanes were not substantially similar property under Section 1. 46-4(d)(4).

Court's Reasoning

The court found that the 1981 lease satisfied the 50% requirement of Section 46(e)(3)(B) as it had a fixed two-year term without an option to renew, and there was no evidence indicating that it was reasonably certain at the inception that the lease would be extended beyond the stated term. The court rejected the Commissioner's argument that the term should be considered indefinite due to the related-party nature of the transaction, noting that Congress did not deny investment credits to noncorporate lessors based on relatedness alone. The court also declined to aggregate the leases of the old and new airplanes, as they were not negotiated simultaneously and were not substantially similar property. The court's decision emphasized the importance of respecting the form of the transaction unless there is clear evidence of abuse.

Practical Implications

This decision underscores the importance of the stated lease term in determining eligibility for investment credits for noncorporate lessors. It highlights that the IRS must provide evidence of abuse or tax motivation to challenge the stated term of a lease, particularly in related-party transactions. The ruling also clarifies that successive leases of different properties are not to be aggregated unless they are negotiated simultaneously and involve substantially similar property. This case may impact how noncorporate lessors structure lease agreements to qualify for investment credits and how the IRS scrutinizes such transactions, especially those between related parties. Subsequent cases may reference Sauey when addressing similar issues regarding the application of Sections 38 and 46(e)(3)(B).

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