Union Pacific Corp. v. Commissioner, 91 T. C. 32 (1988)

The operating costs of rail-test cars and investments in mobile homes used for employee housing are not eligible for investment tax credits.

Summary

Union Pacific Corp. sought investment tax credits for the operating costs of rail-test cars used to detect defective railroad tracks and for investments in mobile homes provided to employees in remote areas. The Tax Court ruled that neither the rail-test car operating costs nor the mobile homes qualified as section 38 property eligible for the investment tax credit. The court determined that rail-test car costs were general maintenance expenses rather than installation costs, and mobile homes were used predominantly for lodging, thus excluded from the credit.

Facts

Union Pacific Corp. operated rail-test cars to detect flaws in railroad tracks, which were then replaced. The company also provided mobile homes rent-free to certain employees responsible for maintaining sections of track in remote areas. Union Pacific claimed investment tax credits for both the operating costs of the rail-test cars and its investment in the mobile homes.

Procedural History

Union Pacific filed a petition in the United States Tax Court challenging the Commissioner's determination of tax deficiencies for the years 1975-1977. The Tax Court addressed whether the costs of operating rail-test cars and the investments in mobile homes qualified for the investment tax credit under section 38 of the Internal Revenue Code.

Issue(s)

1. Whether the costs incurred to operate rail-test cars are includable in Union Pacific's qualified investment in section 38 property.
2. Whether Union Pacific's investment in mobile homes used as section housing qualifies as section 38 property.

Holding

1. No, because the costs of operating rail-test cars are general maintenance costs rather than installation costs of replacement track material.
2. No, because the mobile homes constitute lodging and are therefore excluded from section 38 property under the lodging exception.

Court's Reasoning

The court applied section 48(a)(9) of the Internal Revenue Code, which includes replacement track material in section 38 property if detected by rail-test cars, but only the costs of installation, not detection, are included. The court clarified that rail-test car operating costs are a step removed from installation costs, thus not qualifying as “related installation costs. ” Regarding the mobile homes, the court interpreted the lodging exception under section 48(a)(3) to include any place used predominantly for lodging, regardless of whether rent is charged. The court found no basis in the statute, legislative history, or regulations to limit the lodging exception to rental properties only.

Practical Implications

This decision clarifies that only direct costs associated with installing replacement track material qualify for investment tax credits, excluding costs of detection or maintenance. Businesses must carefully distinguish between these costs when calculating credits. Additionally, the ruling extends the lodging exception to non-rental properties, impacting how companies treat investments in employee housing for tax purposes. Subsequent cases and tax regulations have continued to refine these distinctions, affecting how railroads and other industries approach investment tax credits.

