Borchers v. Commissioner, 95 T. C. 82 (1990)

To claim the investment tax credit, noncorporate lessors must prove that the realistic contemplation of the lease term is less than 50% of the useful life of the leased property.

Summary

In Borchers v. Commissioner, the Tax Court denied the taxpayers' claim for an investment tax credit on computer equipment leased to their wholly-owned corporation. The taxpayers argued that the one-year lease terms satisfied the requirement that the lease term be less than 50% of the property's six-year useful life. However, the court found that the taxpayers failed to prove that the leases were not intended to be indefinite in duration, despite their formal one-year terms. The court emphasized that the burden of proof remained on the taxpayers and was not shifted to the Commissioner, even though the case was submitted on a stipulated record. This decision underscores the importance of proving the realistic contemplation of lease terms when claiming tax credits for property leased to related parties.

Facts

Richard J. Borchers and Jane E. Borchers purchased computer equipment in 1982 and leased it to their wholly-owned corporation, Decision Systems, Inc. , under one-year leases. These leases were renewed annually in subsequent years. The taxpayers claimed an investment tax credit for the 1982 equipment, asserting that the lease terms were less than 50% of the equipment's six-year useful life. The Commissioner challenged this claim, arguing that the leases were intended to be indefinite in duration.

Procedural History

The case was initially decided by the Tax Court in favor of the taxpayers (T. C. Memo. 1988-349). The Commissioner appealed, and the Eighth Circuit vacated and remanded the case, questioning the Tax Court's application of factors and burden of proof (889 F. 2d 790). On remand, the Tax Court reconsidered the case and ultimately ruled in favor of the Commissioner.

Issue(s)

1. Whether the fact that the case was submitted on a stipulated record changes the taxpayers' burden of proof.
2. Whether the taxpayers carried their burden of proof to establish that the formal one-year 1982 leases were not intended to be substantially indefinite in duration.

Holding

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1. No, because the fact that a case is fully stipulated does not alter the burden of proof, which remains on the taxpayers.
2. No, because the taxpayers failed to provide sufficient evidence to show that the leases were not intended to be indefinite, despite their formal one-year terms.

Court’s Reasoning

The court applied the “realistic contemplation” test, examining whether the parties intended the leases to be for the stated one-year term or for an indefinite period. The court considered factors such as the lessor’s control over the lessee, the exclusive nature of the leasing relationship, and the pattern of lease renewals. The court emphasized that the burden of proof remained on the taxpayers and was not shifted to the Commissioner, even in a fully stipulated case. The court found that the taxpayers’ reliance on the formal lease terms was insufficient to carry their burden of proof, given the lack of evidence regarding the parties’ realistic contemplation of the lease duration. The court distinguished this case from Sauey v. Commissioner, where the taxpayer had leased property to different entities, suggesting a more limited lease term.

Practical Implications

This decision highlights the importance of proving the realistic contemplation of lease terms when claiming tax credits for property leased to related parties. Taxpayers must provide evidence beyond formal lease documents to show that the lease term is less than 50% of the property’s useful life. This may include demonstrating a pattern of leasing to unrelated parties or showing that the lessee has the ability to terminate the lease. The decision also reinforces the principle that the burden of proof remains on the taxpayer, even in fully stipulated cases. Practitioners should be cautious when structuring lease arrangements with related parties and be prepared to provide evidence of the parties’ intent regarding the lease term. This case has been cited in subsequent decisions, such as Owen v. Commissioner and McEachron v. Commissioner, which have applied the “realistic contemplation” test to similar factual scenarios.

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