E. I. du Pont de Nemours & Co. v. Commissioner, 101 T. C. 1 (1993)

The Treasury Department's regulation under section 58(h) of the Internal Revenue Code, which adjusts credits freed up by nonbeneficial tax preferences, is valid as a reasonable implementation of the congressional mandate to adjust tax preferences when they do not result in a tax benefit.

Summary

Du Pont and affiliated corporations challenged the validity of Treasury Regulation section 1. 58-9, which applies the tax benefit rule to the minimum tax under section 58(h). The regulation adjusts credits freed up by nonbeneficial tax preferences. The court upheld the regulation as a valid exercise of the Treasury's authority, consistent with the statute's purpose to prevent minimum tax imposition when preferences do not yield a tax benefit. The decision impacts how tax preferences and credits are treated under the minimum tax regime, ensuring that the tax benefit rule is applied when credits are utilized in subsequent years.

Facts

The Du Pont group reported tax preference items of $177,082,305 for 1982 but had sufficient credits to offset their regular tax liability fully. These credits, including investment and energy credits, were carried back to earlier tax years, resulting in a tax benefit. The Commissioner determined deficiencies totaling $25,633,133 based on Regulation section 1. 58-9, which reduces credits freed up by nonbeneficial preferences by the amount of minimum tax that would have been due if a tax benefit had been realized in the year the preferences arose.

Procedural History

The case was submitted to the Tax Court fully stipulated. The court reviewed the validity of Regulation section 1. 58-9, which was issued under the authority of section 58(h) of the Internal Revenue Code. The regulation's validity was contested by Du Pont, who proposed an alternative method for adjusting tax preferences. The Tax Court upheld the regulation's validity and entered decisions for the Commissioner.

Issue(s)

1. Whether Treasury Regulation section 1. 58-9, which reduces credits freed up by nonbeneficial tax preferences, is a valid exercise of the Treasury's authority under section 58(h) of the Internal Revenue Code?

Holding

1. Yes, because the regulation reasonably implements the congressional mandate in section 58(h) by adjusting the effect of tax preferences when they do not result in a

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tax benefit in the year they arise, and by imposing a tax cost when the freed-up credits are used in subsequent years.

Court’s Reasoning

The court found that the regulation was a reasonable and consistent interpretation of section 58(h), which directs the Secretary to adjust tax preferences that do not result in a tax benefit. The court emphasized that the regulation effectively reduces or ignores nonbeneficial preferences in the year they arise, consistent with prior case law like First Chicago Corp. v. Commissioner. The regulation’s credit-reduction mechanism ensures that the tax benefit rule is applied when credits are utilized in subsequent years, preventing taxpayers from escaping minimum tax consequences entirely. The court rejected the argument that the regulation impermissibly adjusts credits rather than preferences, noting that the initial adjustment of preferences in the year they arise satisfies the statutory language. The court also dismissed claims of bad faith in the regulation’s promulgation, as it did not foreclose taxpayer relief and was not inconsistent with prior case law.

Practical Implications

This decision affirms the Treasury’s authority to issue regulations that adjust the effect of tax preferences under the minimum tax regime. Practitioners must consider the regulation when advising clients on the use of tax credits, particularly those freed up by nonbeneficial preferences. The ruling ensures that taxpayers cannot avoid minimum tax consequences by carrying back or over credits without accounting for the tax benefit rule. It also highlights the importance of understanding how regulations interact with statutory provisions, especially in complex areas like tax credits and preferences. Subsequent cases may need to address the regulation’s application in post-1986 years under the alternative minimum tax regime.

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