

## ***Suzy's Zoo v. Commissioner, 114 T. C. 1 (2000)***

A taxpayer is considered the producer of property for UNICAP purposes when it retains ownership and control over the production process, even if the physical production is outsourced.

### **Summary**

Suzy's Zoo, a corporation selling paper products featuring cartoon characters, argued it was a reseller exempt from the UNICAP rules, but the Tax Court held otherwise. The court determined that Suzy's Zoo produced its products because it owned the cartoon characters, controlled the production process, and retained ownership of the final products until sale. The court also ruled that Suzy's Zoo did not qualify for the artist exemption due to insufficient stock ownership by its artist-shareholder. The decision impacts how businesses with outsourced production must account for costs under UNICAP rules.

### **Facts**

Suzy's Zoo, a corporation primarily owned by Suzy Spafford, developed and sold paper products featuring her original cartoon characters. The company's employees created the characters, which were then sent to independent printers who reproduced them onto paper products according to Suzy's Zoo's specifications. The printers could not sell the products or the characters independently. Suzy's Zoo's gross receipts for the tax year in question were over \$5 million, with 84% of its stock owned by Spafford and the rest by unrelated individuals.

### **Procedural History**

The Commissioner of Internal Revenue determined a deficiency in Suzy's Zoo's federal income tax for the taxable year ended June 30, 1994, asserting that the company was subject to the UNICAP rules. Suzy's Zoo petitioned the U. S. Tax Court, which held that the company was indeed a producer under the UNICAP rules and not exempt under the artist exemption. The court also determined that the year of change for accounting purposes was the year in which the method was changed to comply with UNICAP rules.

### **Issue(s)**

1. Whether Suzy's Zoo is a producer of its paper products under the UNICAP rules, thus not qualifying for the small reseller exception?
2. Whether Suzy's Zoo qualifies for the artist exemption under section 263A(h) of the Internal Revenue Code?
3. Whether the taxable year in which Suzy's Zoo's method of accounting was changed to comply with UNICAP rules is the "year of change" for purposes of section 481?

## **Holding**

1. No, because Suzy's Zoo retained ownership and control over the production process, making it the producer rather than a reseller of its paper products.
2. No, because Suzy Spafford did not own "substantially all" of Suzy's Zoo's stock, which is required for the artist exemption.
3. Yes, because the year of change for section 481 purposes is the year in which the method of accounting was actually changed to comply with UNICAP rules.

## **Court's Reasoning**

The court applied section 263A of the Internal Revenue Code, which requires capitalization of certain costs for property produced by the taxpayer. The court determined that Suzy's Zoo was the producer of its paper products because it owned the original cartoon drawings and controlled the entire production process, including the specifications given to the printers. The court rejected Suzy's Zoo's argument that it was a reseller, noting that the printers did not have a proprietary interest in the products and could not sell them independently. Regarding the artist exemption, the court found that Suzy Spafford did not meet the "substantially all" stock ownership requirement. For the year of change under section 481, the court held that it was the year Suzy's Zoo actually changed its accounting method to comply with UNICAP rules, not the year the rules first became applicable.

## **Practical Implications**

This decision clarifies that a taxpayer can be considered a producer under the UNICAP rules even if it outsources the physical production of its goods, as long as it retains ownership and control over the production process. Businesses that engage in similar production arrangements must ensure they are properly capitalizing costs under the UNICAP rules. The ruling also underscores the importance of meeting specific stock ownership requirements for exemptions like the artist exemption. Subsequent cases have referenced this decision in determining producer status under UNICAP rules, affecting how companies structure their production and accounting practices.