Payless Cashways, Inc. v. Commissioner, 114 T. C. 72 (2000)

A building qualifies as a 'world headquarters' for investment tax credit purposes only if the company has substantial international operations directed from that location.

Summary

In Payless Cashways, Inc. v. Commissioner, the U. S. Tax Court ruled that Payless could not claim an investment tax credit under the Tax Reform Act of 1986's transitional rules because its headquarters did not qualify as a 'world headquarters'. Payless leased and equipped parts of a building in Kansas City but lacked sufficient international operations. The court also found that Payless did not meet the 'equipped building rule' as it failed to prove it had a specific written plan and had committed more than half the cost of the equipped building by the required date. This decision clarifies the requirements for claiming investment tax credits under the transitional provisions of the Tax Reform Act and impacts how companies must structure their operations to qualify for such credits.

Facts

Payless Cashways, Inc. (Payless) leased and equipped parts of a building in Kansas City, Missouri, for its corporate headquarters. The building was owned by Two Pershing Square, Ltd. , a limited partnership in which Payless held a 16. 67% interest. Payless claimed an investment tax credit for equipment and furnishings placed in service in 1986. Payless purchased merchandise from foreign vendors for domestic sale, but it had no foreign stores, employees stationed abroad, or foreign income. Payless also engaged in a joint venture in Mexico starting in 1993, but this was after the year in question.

Procedural History

The Commissioner of Internal Revenue disallowed Payless' claimed investment tax credits for the tax year ending November 29, 1986. Payless petitioned the U. S. Tax Court for a redetermination of the deficiency. The court addressed whether Payless qualified for the investment tax credit under the 'world headquarters rule' and the 'equipped building rule' of the Tax Reform Act of 1986.

Issue(s)

1. Whether Payless' headquarters qualified as a 'world headquarters' under TRA section 204(a)(7), allowing it to claim an investment tax credit?
2. Whether Payless satisfied the requirements of the 'equipped building rule' under TRA section 203(b)(1)(C) to claim the investment tax credit?

Holding

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1. No, because Payless did not have substantial international operations directed from its headquarters, which is required to classify a building as a ‘world headquarters’.
2. No, because Payless failed to establish that it had a specific written plan and had incurred or committed more than one-half of the total cost of the equipped building by December 31, 1985.

Court’s Reasoning

The court defined ‘world headquarters’ as requiring substantial international operations, such as foreign employees, foreign source income, or foreign subsidiaries, none of which Payless possessed in 1986. The court rejected Payless’ arguments that purchasing foreign merchandise for domestic sale and borrowing from international capital markets constituted substantial international operations. Regarding the ‘equipped building rule’, the court held that Payless did not have a specific written plan, and even if it did, Payless could not prove it had committed or incurred more than half the cost of the building by the deadline. The court emphasized that the taxpayer claiming the credit must be the party with the plan and the commitment of costs. The decision reflects a strict interpretation of the transitional rules, requiring clear evidence of international operations and financial commitments.

Practical Implications

This ruling clarifies that companies must have substantial international operations to claim investment tax credits under the ‘world headquarters rule’. It impacts how companies structure their international activities and headquarters to qualify for tax benefits. The decision also underscores the importance of having a detailed, written plan and committing significant costs before the specified deadline to claim credits under the ‘equipped building rule’. Practitioners must advise clients on the strict requirements for claiming transitional investment tax credits and ensure that their clients’ operations and financial commitments align with these rules. Subsequent cases have reinforced this interpretation, affecting how businesses approach tax planning in relation to international operations and building projects.

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