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ISSUE

Whether the structure housing refrigerated storage equipment qualifies for investment tax credit (ITC) as "section 38 property" defined by section 48 of the Internal Revenue Code of 1954 (now revoked).

EXAMINATION DIVISION POSITION

Refrigeration machinery and components, meeting the definition of "other tangible property (not including a building and its structural components)" under I.R.,C. § 48(b), is qualified "section 38 property." However, the Code distinguishes this refrigeration equipment from otherwise independent buildings and structures housing such equipment. Independent structures are not qualified "section 38 property." See Treas. Reg. § 1.48-1(e)(1). In the usual case, where a taxpayer claims ITC for the cost of both refrigeration equipment and structural components of the equipment's housing, Examination disallows ITC for the cost attributable to independent structures.

DISCUSSION

Section 48 of the Internal Revenue Code provides that the term "section 38 property" means --

(A) tangible personal property (other than air conditioning or heating unit, or

(B) other tangible property (not including a building and its structural components) but only if such property --

(i) is used as an integral part of manufacturing, production, or extraction or of furnishing transportation, communications, electrical energy, gas, water, or sewage disposal services, or

(ii) constitutes a research facility used in connection with any of the activities referred to in clause (i), or

(iii) constitutes a facility used in connection with any of the activities referred to in clause (i) for the bulk storage of fungible commodities (including commodities in a liquid or gaseous state), . .

Regulations 1.48-1(e)(1) states that buildings and structural components thereof do not qualify as section 38 property. The term "building" includes, for example, structures such as apartment houses, factory and office buildings, warehouses, barns, garages, railway or bus stations, and stores. A structure is "section 38 property" rather than a building if it is: (1) a structure which is essentially an item of machinery or equipment, or (2) a structure which houses property used as an integral part of an activity specified in section 48(a)(1)(B)(i) if the use of the structure is so closely related to the use of such property that the structure clearly can be expected to be replaced when the property it initially houses is replaced. Factors which indicate that a structure is closely related to the use of the property it houses include the fact that the structure is specifically designed to provide for the stress and other demands of such property and the fact that the structure could not be economically used for other purposes.

Therefore, the question of whether a structure is defined as "section 38 property" is heavily based on the function of the structure. Loda Poultry Co., Inc. v. Commissioner, 88 T.C. 816 (1987). **L & B Corp. v. Commissioner**, 862 F.2d 667 (8th Cir. 1988), **rev'g** 88 T.C. 744 (1987), is the case where the credit was disallowed because a structure housing refrigeration equipment functioned independently as a building. The court concluded that a structure functions as a building where it provides shelter for significant machine or animal activity, or if it provides working space for humans. **See also, Des Moines Cold Storage Co., Inc. v. Commissioner**, T.C.memo. 1988-241.

In Central Citrus Co. v. Commissioner, 58 T.C. 365 (1972), the Tax Court was urged not to partition an asset while considering whether it qualified for investment credit. The Court responded that it had not hesitated to make apportionments where one portion of an asset qualified and another did not. Munford, Inc. v. Commissioner, 87 T.C. 463 (1986), aff'd 849 F.2d 1398 (11th Cir. 1988); Consolidated Freightways, Inc. v. Commissioner, 74 T.C. 786 (1980), aff'd on this point 708 F. 2d 1385 (9th Cir. 1983); Scott Paper Co. v. Commissioner, 74 T.C. 137 (1980); Catron v. Commissioner, 50 T.C. 306 (1968), acq., 1972-2 C.B.1. Thus, the Courts have not only looked to the asset as a whole but also to its separate functioning parts.

Although the investment tax credit was repealed for property placed in service after 1985, this issue remains important because refrigerated structures may be depreciated over a shorter period if they are classified as tangible property rather than as buildings.