

A Token of Our Depreciation

BY LAWRENCE SAVELL

As Spring (or, more precisely, April 15) approaches, many a person's thoughts turn to whether his or her tax liability can in any way be limited. Some may hope that money spent on collector cars can be deducted, or that other tax advantages may flow from their automotive investments.

Whether or not such is the case depends on the facts of each situation and the applicable law. Nevertheless, two general points can be made: (1) your honest expectations in this area may ultimately be disappointed; and (2) your best insurance against a costly surprise from Uncle Sam is to consult in advance with an experienced tax professional who is or becomes familiar with your particular circumstances.

Several cases have dealt with the tax implications of collector car ownership and investment, often addressing whether depreciation may be deducted. (Depreciation here is generally defined as the write-off for tax purposes of the cost or other measured value ("basis") of an asset over its estimated useful life.) In some of these cases, unfortunately, the courts have ruled that the collectors were not entitled to the tax benefits the collectors thought they had.

The case of *Extrusions Division, Inc. v. Commissioner of Internal Revenue*, decided by the United States Tax Court on August 7, 1995, raised the issues of who really was the owner of a car, and who was the person or entity that incurred the expenses in question. The Extrusions case involved an impressive collection of automobiles: a 1931 Auburn, a 1929 Auburn, a 1926 Stutz, a 1932 Packard, a 1929 Packard, a 1929 LaSalle, a 1929 Rolls-Royce, a 1928 Ford, a 1912 Franklin, a 1906 Autocar, and a 1930 Buick.

Unfortunately for the taxpayer, the court sustained the Commissioner's determination that the company could not deduct depreciation on the cars in certain prior tax years under a provision of the Internal Revenue Code as it existed at the time. The court ruled that the company had failed to prove that it had made a capital investment in the automobiles. The court focused on evidence that others than the company had apparently supplied the funds for the purchase of the automobiles. It also noted that none of the cars were titled in the company's name, and that there was no reliable evidence of the company's ownership of or other investment in them.

In another case, *Anderson v. Commissioner of Internal Revenue*, decided on October 26, 1995, the Tax Court ruled that taxpayers Jay and Helen Anderson could not deduct depreciation under certain Code provisions in certain tax years for a prototype high mileage automobile built by Mr. Anderson upon the frame of a 1965 Triumph Spitfire. The

Andersons had argued, and the Commissioner had disagreed, that they had been in the business of selling the car, or copies of it, during the years at issue.

The court noted that the test relating to the provisions involved was whether the taxpayer had engaged in the activity with the "actual and honest objective of making a profit." Although that expectation need not be a reasonable one, it must be his or her true ("bona fide") goal. The court makes this assessment based on all the facts and circumstances of the case. The taxpayer has the burden of proving this objective.

Courts have set forth a non-exclusive list of factors relevant to this inquiry. No one factor is controlling. They include: (1) the manner in which the taxpayer carries on the activity; (2) the expertise of the taxpayer or his or her advisors; (3) the time and effort expended by the taxpayer in carrying on the activity; (4) the expectation that assets used in the activity may appreciate in value; (5) the success of the taxpayer in carrying on other similar or dissimilar activities; (6) the taxpayer's history of income or losses with respect to the activity; (7) the amount of occasional profits, if any, which are earned; (8) the financial status of the taxpayer; and (9) any elements of personal pleasure or recreation.

Based on its review of the facts, the court concluded that the Andersons had not been engaged in any trade or business with regard to the J car, and had not been engaged in any activity of selling the J car, or copies of it, for profit. Thus, their depreciation deductions were limited by the Code provision to zero, the amount of their gross income from that activity in each of the years at issue.

The two cases discussed here obviously dealt with somewhat-peculiar facts. In cases where one's ownership of and financial investment and profit motive in an existing collector car is clear, the argument for a favorable outcome may be stronger. Nevertheless, such a determination should best be made by a practitioner skilled in the tax field, familiar with your situation. Indeed, early consultation of such an individual in the planning stages—before you undertake a project or spend your money—may maximize the chances for success of your valiant tax reduction efforts.

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