October 31, 1991

COORDINATED ISSUE
FOREST PRODUCTS INDUSTRY
INVESTMENT TAX CREDIT - DEPRECIATION
PAPER MACHINE STRUCTURE

ISSUE

Does the typical structure containing a paper machine qualify as "other tangible property" under section 48(a)(l)(b) or is it a "building" under the same section.

BACKGROUND

A typical paper machine structure contains one or more paper-making machines and is similar to that described in Revenue Ruling 79-l82. The typical structure also contains a large overhead craneway similar to that described in Revenue Ruling 79-l8l, and special foundations similar to those described in Revenue Ruling 79-l83.

LAW AND ANALYSIS

The applicable code and regulations are described in the above-cited Revenue Rulings and are incorporated herein by reference.

INDUSTRY POSITION

Some taxpayers are not following the Service's position as stated in Rev. Rul. 79-l82. They cite Boise Cascade Corporation v. United States, Civil No. l-73-53 (D. Idaho, March l, l977), which ruled in favor of the taxpayer.

The Boise Cascade case was a jury trial held in a small conservative city where the taxpayer is the largest employer and bears the same name as the city. Testimony established that the structure contained not only the paper machine but also other separate activities and operations with space provided for each. It also established that a number of employees were needed to operate the machinery. This appeared to fill the description of "buildings" as contained in Section l.48-l(e)(l) of the Regulations. The Court, however, instructed the jury that in determining whether the structure qualified as Section 38 property, "working space and employee activity within the structure which is merely supportive of and ancillary to the principal purpose of, indicates that the structure qualifies".

It appears the Court relied on Thirup v. Commissioner, 508 F.2d 915 (9th Cir. 1974) as rationale for its instructions. It was held in Thirup that human labor in a greenhouse, which was merely supportive of and ancillary to the production of flowers, did not cause

the greenhouse to be a building. However, if soil, light, and water are provided in proper amounts, greenhouse products are essentially self-produced without the aid of human labor. The production in a paper machine structure is not self-supportive. Instead regular and continuous human labor is required in the production of paper and in its trimming, cutting, packaging, and preparation for shipment. Thus, it was an error to extend the rationale of Thirup to a paper machine building. The Court also erred in charging the jury that "easy adaptability" to a different use indicates that the structure does not qualify for the credit. The correct standard contained in the Regulations is whether the structure is economically adaptable to a different use.

SERVICE POSITION

For reasons stated in Revenue Ruling 79-l82, a paper machine structure is a building and therefore is not Section 38 property. This position has been sustained in Scott Paper Company v. Commissioner, 74 TC 137, in which five paper machine structures were found to be buildings. However, for reasons stated in Revenue Rulings 79-l8l and 79-l83, a portion of the costs, attributable to the craneway support columns and foundations, does qualify as Section 38 property.

ADDENDUM

Although the investment tax credit has been repealed, the issue continues due to the difference in depreciation periods for machinery v. buildings and the different treatment of construction period interest under section 263A of the Code for property with a long useful life [263A(f)].