

May 1976

# Taxation--Fourth Circuit Disallows Leaseback Deductions

W.W.P.

Follow this and additional works at: <https://researchrepository.wvu.edu/wvlr>



Part of the [Tax Law Commons](#)

---

## Recommended Citation

W.W.P., *Taxation--Fourth Circuit Disallows Leaseback Deductions*, 78 W. Va. L. Rev. (1976).

Available at: <https://researchrepository.wvu.edu/wvlr/vol78/iss3/11>

This Abstracts is brought to you for free and open access by the WVU College of Law at The Research Repository @ WVU. It has been accepted for inclusion in West Virginia Law Review by an authorized editor of The Research Repository @ WVU. For more information, please contact [ian.harmon@mail.wvu.edu](mailto:ian.harmon@mail.wvu.edu).

Mr. Justice Marshall, joined by Mr. Justice Brennan, dissented on the ground that arrests should be subject to the same requirements with regard to warrants as searches.

The Court also reversed the ninth circuit's ruling that the search was involuntary under the totality of the circumstances rule set forth in *Schneckloth v. Bustamonte*, 412 U.S. 218 (1973). The Court in deciding *Schneckloth* distinguished the facts in that case from a situation in which the consent to search was given while the defendant was in custody, and declined to make a determination of the proper standard to be applied in such a case. The Court here clearly ruled that the *Schneckloth* "totality of the circumstances" test would be applied even when the defendant was in custody at the time of the consent. *United States v. Watson*, 96 S. Ct. 820 (1976).

J.P.B.

## TAXATION—FOURTH CIRCUIT DISALLOWS LEASEBACK DEDUCTIONS

In a significant tax case, *Perry v. U.S.*, 520 F.2d 235 (4th Cir. 1975), the fourth circuit has ruled that rental payments made by two physician-taxpayers for the use of a medical building, which they had previously transferred to trusts for the benefit of their children, were not deductible under section 162(a)(3) of the Internal Revenue Code of 1954.

The physicians, partners in a medical partnership, created a "Clifford Trust" under sections 671-678 of the Internal Revenue Code of 1954. Later each conveyed to the trust under essentially the same terms his half interest in some property upon which they had constructed an office building for their practice. The same bank was named as corporate trustee with broad administrative powers, and each physician-taxpayer was the settlor to whom the remainder interests were reserved upon expiration of the trust or the death of the beneficiaries, whichever should occur first.

A leaseback of the office building was arranged prior to establishing the trust whereby each taxpayer leased a one-half interest in the building with monthly rent of \$200 to be paid for the duration of each respective trust. The intended effect of this leaseback arrangement, of course, was to divert a part of each taxpayer's

income to his children as rent via the trust while at the same time deducting the rental payments as ordinary and necessary business expenses.

The other circuits have split on this issue. The fifth circuit has held in *Van Zandt v. Commissioner*, 341 F.2d 440 (5th Cir. 1965) that similar rental payments were not deductible, while the seventh circuit in *Skemp v. Commissioner*, 168 F.2d 598 (7th Cir. 1944) allowed the deduction.

The district court in *Perry* had followed the *Skemp* case as controlling and allowed the deduction largely on the grounds that the independence of the corporate trustee was firmly established. *Perry v. U.S.*, 376 F. Supp. 15 (E.D.N.C. 1974). The district court also looked to the fact that the rental payments made by the taxpayer-physicians were for the use of the property and did not enlarge their ownership. Additionally, the district court rejected the government's contention that since the taxpayers retained an equity in the property they were precluded from deducting the rental payments under section 162 of the Internal Revenue Code of 1954.

The fourth circuit, however, reversed the district court and chose instead to apply the *Van Zandt* case which it characterized as being "in its essential elements, identical to the instant transactions." *Perry v. U.S.*, 520 F.2d 235, 237 (4th Cir. 1975). The court regarded the fact that in *Van Zandt* the taxpayer himself was named as trustee as inconsequential while at the same time deeming the "independence" of the corporate trustee in *Perry* as "illusory." In disallowing the deduction the court viewed the creation of the trust and the leaseback as a single transaction and held that as a whole the obligation to pay rent was not an ordinary and necessary expense motivated by a real business purpose.

W. W. P.