## *Casel v. Commissioner, 79 T. C. 424 (1982)*

The IRS regulation treating a partnership as an aggregate of individuals for applying section 267 is valid, and real estate taxes and interest accrued before purchase must be capitalized, not deducted.

### Summary

In Casel v. Commissioner, the U. S. Tax Court upheld the validity of IRS regulations applying section 267 to disallow deductions for unpaid management fees accrued by a partnership to a related corporation. Edward Casel, a partner, could not deduct his share of partnership losses due to these fees. Additionally, the court ruled that Casel could not deduct real estate taxes and interest accrued on a property before he purchased it at a sheriff's sale. The decision emphasizes the importance of distinguishing between entity and aggregate theories of partnerships and clarifies the capitalization of pre-acquisition taxes and interest.

### Facts

Edward Casel was a 50% partner in a partnership that managed the Chelsea Towers Apartments, purchased from HUD. The partnership accrued but did not pay management fees to Casel Agency, Inc. , a corporation owned by Casel and his family, due to financial difficulties and legal advice against payment while delinquent on the HUD mortgage. Casel claimed deductions for his share of the partnership's losses, which included these unpaid fees. Separately, Casel purchased office property at a sheriff's sale, subject to unpaid real estate taxes and interest, and sought to deduct these payments on his tax return.

### Procedural History

The Commissioner of Internal Revenue disallowed Casel's claimed deductions for both the partnership losses related to unpaid management fees and the real estate taxes and interest paid after purchasing the office property. Casel petitioned the U. S. Tax Court, which upheld the Commissioner's determinations on both issues.

### Issue(s)

1. Whether the IRS regulation treating a partnership as an aggregate of individuals for applying section 267 is valid?
2. Whether petitioners may deduct taxes and interest paid with respect to real estate to the extent that such taxes and interest accrued prior to the date that taxpayers acquired an interest in the property?

### Holding

1. Yes, because the regulation is consistent with the legislative history and case law supporting the application of the aggregate theory of partnerships to section 267,

 

ensuring accurate income reflection by disallowing deductions for unpaid expenses to related parties.
2. No, because sections 163 and 164 require the capitalization of real estate taxes and interest accrued before the taxpayer's ownership interest, as these payments are considered part of the property's purchase price.

**Court's Reasoning**

The court reasoned that the IRS regulation applying section 267 to partnerships is valid because it aligns with the legislative intent and judicial interpretations under the 1939 and 1954 Codes, which favored an aggregate theory of partnerships to prevent tax avoidance through related-party transactions. The court cited Commissioner v. Whitney and Liflans Corp. v. United States as precedents supporting this approach. Regarding the real estate taxes and interest, the court followed the principle established in Estate of Schieffelin v. Commissioner and Hyde v. Commissioner that such payments must be capitalized as part of the property's cost when they accrue before the taxpayer's ownership. The court rejected Casel's arguments that the HUD mortgage agreement required accrual accounting for tax purposes and that the sheriff's inability to claim deductions should affect his own.

**Practical Implications**

This decision clarifies that IRS regulations can treat partnerships as an aggregate of individuals for certain tax purposes, impacting how deductions are calculated in transactions with related parties. Practitioners must consider section 267 when advising clients on partnership transactions, ensuring that accrued but unpaid expenses to related entities are not deducted. Additionally, the ruling reinforces that real estate taxes and interest accrued before a property's purchase must be capitalized, affecting how buyers account for these costs in their tax planning. This case has been cited in subsequent rulings, such as in the context of section 267's application to partnerships and the treatment of pre-acquisition taxes and interest.

 