Gordon v. Commissioner, 85 T. C. 309 (1985)

Amortization deductions are disallowed when a taxpayer attempts to create them by splitting nondepreciable assets into term and remainder interests without additional investment.

Summary

Everett Gordon and his wife, as trustee of a family trust, entered into joint purchase agreements to buy municipal bonds, with Gordon purportedly purchasing the income interests and the trust the remainder interests. The IRS disallowed Gordon's amortization deductions for the income interests, arguing that he essentially bought the entire bonds and donated the remainder interests to the trust. The Tax Court agreed, ruling that the transactions lacked substance and were merely an attempt to create deductions by splitting nondepreciable assets, thus disallowing the deductions under the principles established in United States v. Georgia Railroad & Banking Co. and Lomas Santa Fe, Inc. v. Commissioner.

Facts

Everett Gordon, a physician, and his wife Marian entered into joint purchase agreements to buy municipal bonds. Under these agreements, Gordon would purchase the income interests for his life, while the family trust, with Marian as trustee, would purchase the remainder interests. They executed similar agreements with a pension trust. The agreements were structured to allow Gordon to claim amortization deductions for his cost of the income interests. The family trust's funds for purchasing the remainder interests primarily came from Gordon's cash deposits, which were not consistently reported as gifts on tax returns.

Procedural History

The IRS disallowed Gordon's amortization deductions, leading to a deficiency determination for the tax years 1976-1978. Gordon and his wife petitioned the U. S. Tax Court for a redetermination of the deficiencies. The Tax Court held that Gordon's amortization deductions were properly disallowed because he effectively purchased the entire bonds and transferred the remainder interests to the trusts.

Issue(s)

1. Whether the IRS properly disallowed Gordon's amortization deductions for the cost of the income interests in municipal bonds purchased under joint purchase agreements.

Holding

1. Yes, because in substance, Gordon purchased the bonds in their entirety and the trusts were merely conduits for the remainder interests, the amortization deductions

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were properly disallowed.

Court’s Reasoning

The court focused on the substance of the transactions rather than their form. It found that Gordon effectively purchased the entire bonds and used the trusts as conduits for the remainder interests, which lacked independent substance. The court relied on the principles from United States v. Georgia Railroad & Banking Co. and Lomas Santa Fe, Inc. v. Commissioner, which disallow amortization deductions when a taxpayer attempts to create them by splitting nondepreciable assets without additional investment. Key factors influencing the decision included the family trust’s reliance on Gordon’s cash deposits, the lack of independent decision-making by the trust, and the absence of evidence showing the pension trust’s financial independence. The court emphasized that the transactions were structured primarily to obtain tax benefits, with the trusts serving as mere way stations for cash provided by Gordon.

Practical Implications

This decision clarifies that taxpayers cannot claim amortization deductions by artificially splitting nondepreciable assets into term and remainder interests, particularly when dealing with related parties. Legal practitioners should ensure that joint purchase agreements have genuine economic substance and that trusts or other entities involved have independent financial roles. The ruling impacts estate planning and tax strategies involving trusts, as it limits the ability to use such arrangements to generate tax deductions. Subsequent cases have cited Gordon v. Commissioner to reinforce the principle that substance over form governs the allowability of deductions. This decision also serves as a reminder to report all transfers to trusts accurately for gift tax purposes.

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