Lansburgh v. Commissioner, T. C. Memo. 1987-491

The amount at risk in a leaseback transaction under section 465 is determined by net income, not gross income, and includes only cash contributions and certain borrowed amounts.

Summary

In Lansburgh v. Commissioner, the Tax Court addressed the calculation of the amount at risk under section 465 for a computer purchase-leaseback transaction. The case centered on whether the taxpayer could include rental income used to pay interest on non-flip-flop notes in his amount at risk. The court held that only net income, not gross income, could increase the amount at risk, and the taxpayer was entitled to deductions based on $182,008. 80 of rental income and $34,487 at risk. The court also denied the taxpayer's motion to abate additional interest under section 6621(c) due to the Commissioner's delays, finding them insufficiently severe to warrant such relief.

Facts

In December 1976, the taxpayer entered into a purchase-leaseback transaction with Greyhound Computer Corp. for computer equipment, structured over six years. Payments were evidenced by various promissory notes, including flip-flop notes that changed from non-negotiable recourse to negotiable nonrecourse after a certain date. The equipment was leased back to Greyhound, with rental payments deposited into the taxpayer's bank account and used to make note payments. In 1977, the taxpayer claimed deductions for rental income and interest paid on non-flip-flop notes, arguing these amounts should increase his amount at risk under section 465.

Procedural History

The case initially came before the Tax Court in Lansburgh v. Commissioner, T. C. Memo. 1987-491, where it was determined that the transactions had economic substance and a valid business purpose. The current dispute arose during the Rule 155 tax computation phase, focusing on the calculation of the amount at risk for 1977. The taxpayer also filed a motion to abate additional interest under section 6621(c) due to alleged delays by the Commissioner.

Issue(s)

1. Whether the taxpayer's amount at risk under section 465 for 1977 should include rental income used to pay interest on non-flip-flop notes?
2. Whether the taxpayer's interest deductions under section 163 are subject to the at-risk limitation of section 465?
3. Whether the taxpayer is entitled to an abatement of additional interest under section 6621(c) due to the Commissioner's alleged delays?

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Holding

1. No, because the amount at risk is increased only by net income generated from the activity, not gross income used to pay interest.
2. No, because all deductions incurred in an activity subject to section 465, including interest under section 163, are subject to the at-risk limitation.
3. No, because the Commissioner's delays did not reach the level of severity required for abatement under section 6621(c).

Court's Reasoning

The court applied the statutory language of section 465, which limits deductions to the amount at risk, defined as cash contributed and certain borrowed amounts. The court rejected the taxpayer's argument that rental income used to pay interest should increase the amount at risk, stating that only net income can do so. The court cited section 1. 465-2(a) and 1. 465-22(c) of the Proposed Income Tax Regulations, which support this interpretation. The court also clarified that all deductions, including interest under section 163, are subject to the at-risk limitation when incurred in an activity governed by section 465. Regarding the abatement of interest, the court found that the Commissioner's delays were not as severe as in prior cases like Betz v. Commissioner, thus denying the motion.

Practical Implications

This decision impacts how taxpayers calculate their amount at risk in leaseback transactions, emphasizing the importance of net income over gross income. Practitioners should advise clients to carefully track net income and cash contributions when calculating at-risk amounts. The ruling also clarifies that all deductions, including interest, are subject to section 465's limitations, affecting tax planning for such transactions. Additionally, the court's reluctance to abate interest for delays suggests that taxpayers seeking such relief must demonstrate severe misconduct by the Commissioner. Subsequent cases like Peters v. Commissioner have further developed the application of section 465 beyond tax shelters, reinforcing the principles established in Lansburgh.

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