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day statutory limitation was suspended.[59] Under this analysis, Equity's payments to Mutual fall within the redemption period. As such, they must be included in the amount tendered by the Government to effect redemption under the proposed regulations.[60] Therefore, Equity was entitled to reimbursement for the payments it made during litigation under either approach.

The Treasury regulations proposed under §7425(d) were promulgated to solve the problems posed in *Equity Mortgage Gorp. v. Loftus.*[61] The regulations expressly include payments made during the redemption period in the amount to be tendered but exclude such payments from "expenses necessarily incurred" under §2410(d)(3).[62] Pre-foreclosure payments generally are not included unless they give rise to an interest includable in the debt legally satisfied by the foreclosure sale.[63] With respect to post-redemption payments in an *Equity Mortgage* situation where redemption is incomplete, the payor would be entitled to full reimbursement under principles of equity or limitations of actions.[64] Thus, with the exception of the pre-foreclosure payments, the proposed regulations would achieve the same result as that reached by the Fourth Circuit. Although the Fourth Circuit's holding in *Equity Mortgage* will be replaced by the proposed Treasury regulations, the court's use of equitable principles provides a basis for interpreting new fact situations arising with respect to the Government's exercise of its right of redemption under Internal Revenue Code §7425(d) and 28 U.S.C. §2410(d).

SAMUEL J. WEBSTER

XI. TAXATION

A. Taxability of Special Death Benefits

Special benefits paid by employers to the estates or beneficiaries of deceased employees raise questions concerning both the deducti-

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[59] *Cf.* Brunswick Land Corp. v. Perkinson, 153 Va. 603, 151 S.E. 138 (1930).

[60] Proposed Treas. Reg. §301.7425-1(b)(1)(iv).

[61] *Compare* Temp. Treas. Reg. §400.5-1(c)(2), note 24 *supra,* promulgated before *Equity Mortgage, with* Proposed Treas. Reg. §301.7425-4(b)(1), promulgated following the Fourth Circuit's decision, which includes a separate sub-section, §301.7425-4(b)(1)(iv), for payments made to a senior lienholder.

[62] Proposed Treas. Reg. §§301.7425-4(b)(1)(iv), -4(b)(4). *See* text accompanying notes 32-39 *supra.*

[63] Proposed Treas. Reg. §§301.7425-4(b)(2)(ii); 301.6323(e)-1(a)(6), -1(d); 301.6323(i)-1(b). *See* text accompanying notes 40-54 *supra.*

[64] *See* text accompanying notes 55-60 *supra.*

bility of payments made by the employer[1] and the taxability of payments received by the beneficiaries.[2] In *Pearson v. United States,*[3] the Fourth Circuit considered the taxability of payments received by an employee's widow under a unique death benefit program provided by the Graybar Electric Company.[4] After the death of the taxpayer's husband, Graybar exercised its right of redemption[5] on the Graybar stock held by the decedent at the time of his death. Following the redemption, the taxpayer received payments under a death benefit plan for beneficiaries of stockholders.[6] The Fourth Circuit held[7] that these payments, which bore a close relationship to the employer's

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[1] INT. REV. CODE OF 1954, § 162(a)(1). The section grants a business deduction for salaries or other forms of compensation paid for actual performance of services.

[2] INT. REV. CODE OF 1954, § 61(a)(1). The section defines gross income to include all compensation for services rendered. Internal Revenue Code § 102(a) excludes the value of property acquired by gift from gross income. The Treasury Department ruled that it will regard nearly all employer payments to widows as a form of taxable compensation and not as tax free gifts. Rev. Rul. 102, 1962-2 CUM. BULL. 37, *modifying* Rev. Rul. 326, 1960-2 CUM. BULL. 32.

The first $5,000 of death benefits paid by an employer to the beneficiary or estate of an employer is excluded from gross income. INT. REV. CODE OF 1954, § 101(b)(2)(A). If death benefits qualify as gifts, however, they are not limited to the $5,000 exclusion of § 101(b)(2)(A). Such death benefits are excluded from gross income by § 102(a). Rev. Rul. 102, 1962-2 CUM. BULL. 37, *modifying* Rev. Rul. 326, 1960-2 CUM. BULL. 32.

See generally Comment, *Voluntary Payments to Widows of Corporate Executives: Gifts or Income?*, 62 MICH. L. REV. 1216 (1964); Note, *Payments to Widows of Corporate Executives and Employees—Gifts or Income?*, 49 VA. L. REV. 74 (1963).

[3] 519 F.2d 1279 (4th Cir. 1975).

[4] Graybar's stock is owned entirely by company employees. The stock is subject to a power of redemption upon an employee's death, which Graybar has exercised consistently. Following redemption, the Graybar board is authorized to make payments for the next five years which do not exceed the dividends paid during that period on the amount of stock repurchased. Jensen v. United States, 511 F.2d 265, 268 & n.3 (5th Cir. 1975). The special death benefit plan provides that Graybar is not obligated to make these payments. *Id.* at 268 n.4. In practice, however, the company almost always pays. *Id.* at 268.

The tax consequences of this plan for the employer, Graybar, were contested in Graybar Electric Co. v. Commissioner, 267 F.2d 403 (2d Cir.) (per curiam), *cert. denied,* 361 U.S. 822 (1959). The Second Circuit accepted the Commissioner's argument that the payments were made as part of stock purchases from the estates of deceased stockholders and thus were not deductible by Graybar as compensation under Internal Revenue Code § 162(a)(1). 267 F.2d at 404.

[5] *See* note 4 *supra.*

[6] These special death benefits are made in addition to a regular death benefit program available to all employees and their beneficiaries. Regular death benefits are subject to the $5,000 tax free limitation of Internal Revenue Code § 101(b). *See* note 2 *supra.*

[7] 519 F.2d at 1280.

stock distribution plan,[8] were not gifts and were therefore taxable.[9]

The taxpayer contended that a test adopted by the Fourth Circuit in *Poyner v. Commissioner*[10] should be applied in *Pearson*. The *Poyner* test had been applied on identical facts in a Ninth Circuit decision[11] which held that the payments were gifts and therefore excludable from gross income.[12] The *Poyner* court mentioned four distinct points as being indicative, but not conclusive, of a gift.[13] First, the payments must be made to the beneficiary of a deceased employee rather than to the estate. Second, the corporation can derive no benefit from the payments. Third, the decedent's spouse cannot have performed any services for the corporation. Fourth, the services of the employee must already have been fully compensated.

Conceding that the *Poyner* factors appeared to be satisfied in *Pearson*, the Government nevertheless contended that the payments should be treated as capital gains.[14] To support this contention, the Commissioner argued that the payments were additional consideration for the redemption of stock previously owned by the beneficiary's

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[8] *See* note 4 *supra*.

[9] The Fourth Circuit in *Pearson* did not reach the issue of how the payments should be taxed. Taxpayer originally reported the payments as capital gains, INT. REV. CODE OF 1954, § 1201, and subsequently filed for a refund in this action, INT. REV. CODE OF 1954, § 7422. Since the Fourth Circuit ruled that taxpayer was not entitled to a refund, there was no need to discuss how the payments should be taxed. However, the court noted that alternative treatments include distribution of corporate profits, INT. REV. CODE OF 1954, § 301, or inclusion in gross income, INT. REV. CODE OF 1954, § 61. 519 F.2d at 1280 n.3.

[10] 301 F.2d 287 (4th Cir. 1962). The *Poyner* test actually listed five factors, but two of the five were indistinguishable. The fifth factor, identical with the fourth factor listed in the text, required that there be no obligation on the transferor to pay additional compensation to the deceased employee. *Id.* at 291. The Fourth Circuit in *Poyner* cited the test to Florence S. Luntz, 29 T.C. 647, 650 (1958), which also listed five factors. The test was formulated, however, in Estate of Arthur W. Hellstrom, 24 T.C. 916 (1955), which acknowledged the redundancy of the fifth factor. *Id.* at 920. Later courts have continued to use the five factor variation of the original *Hellstrom* test, as listed in *Florence S. Luntz. See, e.g.*, Jensen v. United States, 511 F.2d 265, 270 (5th Cir. 1975); Harper v. United States, 454 F.2d 222, 225 (9th Cir. 1971). The test incorporated the factors considered important in gift determination prior to Commissioner v. Duberstein, 363 U.S. 278 (1960). *See* note 20 *infra*. After *Duberstein*, the Fourth Circuit adopted the five factors in *Poyner* but indicated that the test was not complete or intended to be conclusive. 301 F.2d at 292.

[11] Harper v. United States, 454 F.2d 222 (9th Cir. 1971). The *Harper* decision was based totally on satisfaction of the five point test, which was also advocated by the taxpayer in *Pearson. See* note 10 *supra*.

[12] INT. REV. CODE OF 1954, § 102(a).

[13] 301 F.2d at 291. *See* note 10 *supra*.

[14] Pearson v. United States, 74-1 U.S. Tax Cas. ¶ 9406, 84,003 (E.D. Va. 1974).

husband.[15] The Commissioner further asserted that Graybar was under a moral or legal duty to make the payments.[16] This duty was an additional factor which the Commissioner contended outweighed the *Poyner* test.[17] According to the government, this moral duty to pay employees' beneficiaries in the future arose from the consistency with which Graybar made these payments over prior years.[18]

The district court in *Pearson* started its analysis with *Commissioner v. Duberstein*,[19] the leading Supreme Court gift determination decision. *Duberstein* held that the transferor's motive is the controlling consideration and that it must be ascertained by objective analysis of all the relevant facts.[20] Accordingly, the district court in *Pearson* sought to determine the motivation for the payments to the taxpayer. The court examined not only the four points stressed by the taxpayer but looked for evidence which might support the Commissioner's contention that a duty to make the payments existed. However, the court found no facts indicating the existence of such a duty.[21] Thus, although their *Duberstein* analysis did not consider the *Poyner* factors to be a definitive statement, the district court concluded that the payments were gifts.[22] The Fourth Circuit reversed and held that the taxpayer was not entitled to a refund for taxes paid on the benefits.

In reversing the district court, the Fourth Circuit wholly adopted the rationale of the recent decision in *Jensen v. United States*,[23] a

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[15] *See* note 4 *supra*.

[16] The Supreme Court in Commissioner v. Duberstein, 363 U.S. 278 (1960), *see* note 20 *infra*, set forth its previously established general principles on gift determination. Referring to its decision in Bogardus v. Commissioner, 302 U.S. 34, 41 (1937), the Court in *Duberstein* reiterated that payments proceeding from " 'the constraining force of any moral or legal duty' " are not gifts. 363 U.S. at 285. The Commissioner phrased his argument in the above terminology. Pearson v. United States, 74-1 U.S. Tax Cas. ¶ 9406, 84,003 (E.D. Va. 1974).

[17] 74-1 U.S. Tax Cas. ¶ 9406 at 84,003.

[18] *Id. See* note 28 *infra*.

[19] 363 U.S. 278 (1960).

[20] *Id.* at 286. The *Duberstein* Court refused to set an absolute standard for determination of the dominant reason for a transferor's action. *Id.* at 286-88. Instead, the Court reviewed general principles expressed in previous opinions. For example, a gift proceeds from generosity, Commissioner v. LoBue, 351 U.S. 243, 246 (1956), or from affection or charity, Robertson v. United States, 343 U.S. 711, 713-14 (1952). In contrast, payments made because of a moral or legal duty, or in anticipation of economic benefit, are not gifts. Bogardus v. Commissioner, 302 U.S. 34, 41 (1937).

[21] 74-1 U.S. Tax Cas. ¶ 9406 at 84,003.

[22] *Id.*

[23] 511 F.2d 265 (5th Cir. 1975). *Jensen* was decided the day after the arguments in *Pearson*. Thus, the circuit conflict between *Jensen* and *Harper*, *see* text accompanying note 11 *supra*, was not known at the time.

Fifth Circuit case with nearly identical facts.[24] The *Jensen* court, like the district court in *Pearson*, began its analysis with *Duberstein*, and acknowledged the need to resolve the gift issue by a close inspection of the facts.[25] While noting the relevance of the *Poyner* test,[26] the court stated that *Duberstein* clearly called for a broader examination of the facts. Specifically, the court noted[27] that the *Poyner* test failed to account for the continuing nature of the payments.[28] The Fifth Circuit agreed with the Commissioner that this history of payments was a crucial fact.[29] Indeed, the Fifth Circuit had previously indicated that the existence of a payment plan is very persuasive against a finding that a payment was a gift, particularly where the operation of the plan resulted in a benefit to the transferor.[30]

When the Graybar plan was subjected to close scrutiny, the *Jensen* court found that a benefit to the employer did, in fact, exist.[31] In determining whether to provide death benefits, Graybar never considered the needs of the individual beneficiaries.[32] Instead, payments seemed to follow automatically when the deceased employee had owned stock.[33] The Fifth Circuit concluded that the high percentage of cases in which payments had been made created an expectation among employees that such payments would continue to be made. Thus, the trend served as an inducement for continued employee participation in the stock purchase plan which, in turn, generated working capital for the company.[34] Since a benefit to the transferor was a factor indicating that a payment was a gift under *Poyner*, that test no longer supported the taxpayer's position.

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[24] The only factual difference between *Pearson* and *Jensen* was that the payments in *Jensen* were made directly to the estate rather than to the beneficiary. 511 F.2d at 270. The Fifth Circuit indicated, however, that this factor, one of the original *Hellstrom* points, was not significant in their decision. *Id.* at 270.

[25] *Id.* at 269.

[26] *Id.* at 270.

[27] *Id.*

[28] Between 1941 and 1957, the additional payments were made in 189 of 193 redemptions. For the years 1960-1972, they were made in 271 of 273 redemptions. The instances in which payments were not made involved beneficiaries remotely related to the stockholding employee from whom the stock was redeemed. *Id.* at 268. Possibly these parties did not even qualify to take under the specific provision of the Graybar plan which required that potential beneficiaries of the special death benefits be qualified to receive regular death benefits. *Id.* at 268 n.5.

[29] *Id.* at 270.

[30] Tomlinson v. Hine, 329 F.2d 462, 466 (5th Cir. 1964).

[31] 511 F.2d at 271.

[32] *Id.*

[33] *See* note 28 *supra*.

[34] 511 F.2d at 271.

After finding this benefit to Graybar, the Fifth Circuit established a second ground for their decision. The circuit court concluded, as the government had originally argued,[35] that a moral obligation to make the payments existed as long as the plan remained in effect.[36] Like the benefit to the employer, this obligation arose from the regular practice of making payments and the resulting expectation of continued payments among the employees. The court determined that it would be unconscionable to deny payments to any one beneficiary when virtually all similarly situated employees had received payments in the past.[37] Thus, as the taxpayer had failed to prove that the payments were entitled to exclusion,[38] the Fifth Circuit held that they were taxable.

In completely adopting the *Jensen* reasoning, the Fourth Circuit failed to establish a rigid standard which would clarify the distinctions between gifts and income. However, a basic principle reiterated by the Supreme Court in *Duberstein* was applied in addition to the factors previously employed by the Fourth Circuit in *Poyner.* Proceeding under a *Duberstein* analysis, the discovery of a moral obligation on the transferor to make payments will be a strong indication that payments are not gifts. Together with the *Poyner* factors, the adoption of the moral obligation criterion establishes a more comprehensive basic test for use in the Fourth Circuit. Ultimately, however, the recipient of death benefits who seeks to exclude those payments from gross income as gifts must prove the contention on the basis of all the facts, rather than relying upon a mechanical application of prior standards which support the finding of a gift.

B. The Fourth Circuit Denies Rental Deductions Under a Clifford Trust Leaseback

In *Perry v. United States,*[1] the Fourth Circuit refused to permit a deduction under Internal Revenue Code § 162(a)(3)[2] for rental pay-

[35] *See* text accompanying note 16 *supra.*

[36] 511 F.2d at 272.

[37] *Id.*

[38] The taxpayer bears the burden of proving that a payment is entitled to exclusion. Welch v. Helvering, 290 U.S. 111 (1933).

[1] 520 F.2d 235 (4th Cir. 1975), *cert. denied,* 44 U.S.L.W. 3389 (U.S. Jan. 13, 1976).

[2] INT. REV. CODE OF 1954, § 162(a)(3). This section allows a deduction for all ordinary and necessary expenses paid or incurred in carrying on a business, including required rental payments. The Treasury Department's policy on deductibility of rental payments to a trust under a leaseback arrangement is stated in Rev. Rul. 9, 1954-1 CUM. BULL. 20, *modified,* Rev. Rul. 315, 1957-2 CUM. BULL. 624. These rulings state

ments on property held in a Clifford trust.[3] The taxpayers[4] in *Perry* had transferred property used in the husband's business to a valid trust[5] for the benefit of their children. Although the trust was irrevocable for a period of ten years and one day, the property was to revert to the grantor following the expiration of the trust. Upon creation of the trust, pursuant to a previous arrangement, the independent trustee immediately leased the property back to the taxpayer's medical partnership at a fixed monthly rate for the duration of the trust. In *Perry,* the court had to decide which of two existing tests should be applied in deciding the deductibility of rental payments made to the trust by the settlor-lessee. The Fourth Circuit concluded that the creation of the trust and leaseback should be considered as a single transaction.[6] Viewing the trustee's powers as illusory, the court held that such payments could not be deducted because there was no valid business purpose for the transaction.[7]

Schemes involving a gift to a trust and a subsequent leaseback by the donor have been a popular income shifting device for many years.[8] The Internal Revenue Code establishes standards for determining the validity of such a short term trust[9] but provides no guidelines for

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that rental payments made to the trust by the grantor will not constitute deductible business expenses. However, the 1957 ruling notes that the rental payments will constitute a completed gift for federal gift tax purposes.

[3] The name "Clifford trust" is derived from Helvering v. Clifford, 309 U.S. 331 (1940), in which the Court held that the settlor of a short term trust, although his wife was the beneficiary, was owner of the trust property for tax purposes. Hence, the term "Clifford trust" has been used to describe any short term intra-family trust. Oliver, *Income Tax Aspects of Gifts and Leasebacks of Business Property in Trust,* 51 CORNELL L.Q. 21, 24 (1965).

[4] The taxpayers in *Perry* and the companion case, Medders v. United States, 520 F.2d 235 (4th Cir. 1975), operated a medical clinic as a partnership in the building which they owned as tenants in common. Each taxpayer conveyed his interest in the building to a trust with his child as beneficiary. The partnership then leased the building back from the two trusts in separate lease agreements. The only factual distinction between the two cases is that the term of the *Medders* trust was slightly longer; the issues presented were identical. 520 F.2d at 237.

[5] Both parties agreed that the trust met the requirements for a Clifford trust under Internal Revenue Code §§ 671-78. 520 F.2d at 237. *See* note 9 *infra.*

[6] 520 F.2d at 238.

[7] *Id.*

[8] The trust-leaseback device shifts income producing property from the high tax bracket of the grantor to the lower tax bracket of the beneficiary, usually the grantor's wife or child. *See generally* Note, *Use of a Trust and Lease-back As A Tax Avoidance Device,* 51 COLUM. L. REV. 247 (1951); Note, *The Gift and Leaseback: A New Tax Avoidance Gimmick,* 59 YALE L.J. 1529 (1950).

[9] In 1954, Congress promulgated standards for determination of the validity, for taxation purposes, of a Clifford trust. INT. REV. CODE OF 1954, §§ 671-78. Under § 673

deciding if rental payments made under a leaseback arrangement by the settlor are deductible.[10] Both the regulations[11] and a congressional report[12] state that the standards for determining the validity of a short term trust[13] do not apply for deciding deductibility of rental payments made to the trust. Since the Internal Revenue Code fails to provide adequate guidelines, the courts have had to develop their own standards.

The courts have established two basic tests to determine the deductibility of rental payments made to a Clifford trust following a leaseback to the settlor.[14] First, some courts, analyzing the gift to the trust and the leaseback as a single transaction, require that a valid business purpose be shown for the whole arrangement.[15] Second, other courts view the creation of the trust and the leaseback as separate transactions.[16] Under the second test, the first step is to evaluate

the grantor shall be treated as the owner of the trust if he has a reversionary interest which may reasonably be expected to take effect within ten years from the date of the transfer. INT. REV. CODE OF 1954, § 673. There are also restrictions on the grantor's retention of administrative powers, INT. REV. CODE OF 1954, § 675, the power to revoke the trust, INT. REV. CODE OF 1954, § 676, and the power to control beneficial enjoyment, INT. REV. CODE OF 1954, § 674. *See generally* Froehlich, *Clifford Trusts: Use of Partnership Interests as Corpus; Leaseback Arrangements*, 52 CALIF. L. REV. 956 (1964).

[10] Rental payments would be deductible, if at all, under § 162(a)(3). INT. REV. CODE OF 1954, § 162(a)(3).

[11] Treas. Reg. § 1.671-1(c)(1971) states in pertinent part: "these sections have no application in determining the right of a grantor to deductions for payments to a trust under a transfer and leaseback arrangement."

[12] S. REP. No. 1622, 83d Cong., 2d Sess. 365 (1954). The report states in pertinent part: Sections 671-78 "also [have] no application in determining the right of a grantor to deductions for payments to a trust under a transfer and leaseback arrangement."

[13] *See* note 9 *supra*.

[14] For comprehensive discussion of the trust and leaseback cases *see* Oliver, *Income Tax Aspects of Gifts and Leasebacks of Business Property in Trust*, 51 CORNELL L.Q. 21 (1965); Note, *Tax Consequences of an Intrafamily Transfer of Business Property into Trust for Dependents with a Leaseback by the Grantor's Business*, 73 COLUM. L. REV. 1420 (1973); Note, *Gift and Leaseback—Tax Planning in the Shadows of Assignment of Income and Business Purpose*, 62 GEO. L.J. 209 (1973).

[15] All courts applying the single transaction test have denied the deduction for rental payments. *See* Wiles v. Commissioner, 491 F.2d 1406 (5th Cir. 1974), *aff'g mem.* 59 T.C. 289 (1972) (taxpayer named himself trustee and commingled business and personal expenses); Chace v. United States, 422 F.2d 292 (5th Cir. 1970) (per curiam), *aff'g* 303 F. Supp. 513 (M.D. Fla. 1969) (taxpayer retained control of trust property by right to renew lease for remainder of trust); Van Zandt v. Commissioner, 341 F.2d 440 (5th Cir.), *cert. denied*, 382 U.S. 814 (1965) (*see* text accompanying notes 20-22 *infra*); White v. Fitzpatrick, 193 F.2d 398 (2d Cir. 1951), *cert. denied*, 343 U.S. 928 (1952) (taxpayer transferred his entire interest in a patent to his wife but retained administrative control).

[16] Courts applying the two-step test have generally allowed a deduction. *See, e.g.*, C. James Mathews, 61 T.C. 12 (1973); Alden B. Oakes, 44 T.C. 524 (1965).

whether the grantor has sufficiently divested himself of the ability to control the property committed to the trust. If the first step is satisfied, the second step is to determine if a business purpose exists for the leaseback itself. Thus, the basic difference between the two tests is whether the gift to the trust and the leaseback should be analyzed as separate events or as a single transaction. The question is essentially one of fact, and courts have continually looked at factors such as the nature and power of the trustee,[17] the terms of the lease,[18] and the retained interest of the taxpayer.[19]

In *Perry*, the Commissioner argued that the entire transaction was merely a device to shelter income and therefore should be disregarded for purposes of taxation.[20] The Government relied primarily on the Fifth Circuit case of *Van Zandt v. Commissioner*[21] in which, unlike *Perry*, the settlor-taxpayer also acted as the trustee. The Fifth Circuit viewed the creation of the trust and the leaseback as a single transaction lacking a valid business purpose and concluded that rent paid under the leaseback was not an ordinary and necessary business expense deductible under § 162(a)(3).[23] Thus, the Commissioner urged

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[17] *Id.*

[18] *See, e.g.*, Brooke v. United States, 468 F.2d 1155 (9th Cir. 1972) (deduction allowed where amount of rent was reasonable); Kirschenmann v. Westover, 225 F.2d 69 (9th Cir.), *cert. denied*, 350 U.S. 834 (1955) (deduction disallowed where amount paid in rent was grossly in excess of fair rental value).

[19] Internal Revenue Code § 162(a)(3) specifically excludes deductions for rental payments where the taxpayer-settlor has retained an equity interest. Three cases denying a deduction for rental payments have mentioned this factor as at least one of several pertinent factors. *See* Chace v. United States, 303 F. Supp. 513 (M.D. Fla. 1969), *aff'd*, 422 F.2d 292 (5th Cir. 1970); Hall v. United States, 208 F. Supp. 584 (N.D.N.Y. 1962); Gibbons v. United States, 70-1 U.S. Tax Cas. ¶ 9365 (D.N.M. 1970).

Two other cases prior to *Perry* have held for the taxpayer on the issue of whether the retained interest constituted a disqualifying equity. *See, e.g.*, Duffy v. United States, 343 F. Supp. 4 (S.D. Ohio 1972), *rev'd on other grounds*, 487 F.2d 282 (6th Cir. 1973), *cert. denied*, 416 U.S. 938 (1974); C. James Mathews, 61 T.C. 12 (1973). *See also* Comment, *Gift and Leaseback: Planning Perspectives in an Unlegislated Field*, 63 KY. L.J. 205, 226 (1975).

[20] Perry v. United States, 376 F. Supp. 15, 19 (E.D.N.C. 1974). The alternative argument raised by the Commissioner for denial of the deduction was that the taxpayer's reversionary interest constituted an equity forbidden by Internal Revenue Code § 162. This argument was rejected by the district count, 376 F. Supp. at 19, and was not discussed by the Fourth Circuit.

[21] 341 F.2d 440 (5th Cir.), *cert. denied*, 382 U.S. 814 (1965).

[22] INT. REV. CODE OF 1954, § 162(a)(3). The concept of a business purpose test originated in Gregory v. Helvering, 293 U.S. 465 (1935). The Court ruled in *Gregory* that although a taxpayer may minimize his taxes by all available means, a transaction giving rise to a business deduction must have a valid business purpose. *Id.* at 469. In applying this test, the *Van Zandt* court stated that factors such as the short term of a trust, reversion to the settlors, and a predetermination of the right to possession of the

the use of the first test, requiring a valid business purpose for the entire transaction.

The taxpayer in *Perry* relied on *Skemp v. Commissioner*[23] in which the Seventh Circuit allowed a rental deduction on facts similar to *Perry*. The *Skemp* court adopted the two-step test.[24] After first observing that the settlor of the trust had surrendered control of the trust property to an independent trustee, the Seventh Circuit analyzed the leaseback as a separate step. Thus, the fact that the taxpayer had voluntarily transferred his business property to the trust was not important. The *Skemp* court only required a business purpose to be shown for the leaseback. Since the taxpayer still needed control of the trust property in order to continue in business, the rent paid under the leaseback was held deductible as an ordinary and necessary business expense.[25]

The Fourth Circuit chose to follow the reasoning in *Van Zandt*, adopting the single transaction test.[26] In evaluating whether there was a valid business purpose, the Fourth Circuit paid particular attention to the function of the trustee.[27] Under the trust instrument, the trustee purportedly was granted broad powers[28] to collect and

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property bear heavily on the element of business purpose. 341 F.2d at 444. For comprehensive discussion of the business purpose test, see Gibbs, *Income Shifting—Recent Trends in Leaseback Transactions*, 19 Sw. L.J. 273 (1965). Internal Revenue Code § 162 itself requires that the payment must be both ordinary and necessary in order to be deductible. *See* note 2 *supra*.

[23] 168 F.2d 598 (7th Cir. 1948). The significant differences in *Skemp* were that the grantor did not retain a reversionary interest, the irrevocable period of the trust was longer, and the property granted to the trust was only partially leased back. *See* text accompanying notes 4 and 5 *supra*.

[24] *See* text accompanying note 16 *supra*.

[25] INT. REV. CODE OF 1939, § 23(a)(1)(A). This section was the predecessor of Internal Revenue Code of 1954, § 162(a)(3). It also required that a business expense be ordinary and necessary in order to be deductible.

[26] In cases involving different tax problems, the Fourth Circuit has looked to the overall effect of multistep transactions. *See* DeTreville v. United States, 445 F.2d 1306 (4th Cir. 1971); J. M. Turner & Co. v. Commissioner, 247 F.2d 370 (4th Cir. 1957); Starr v. Commissioner, 82 F.2d 964 (4th Cir.), *cert. denied*, 298 U.S. 680 (1936).

[27] The Fourth Circuit in *Perry* did not clearly articulate its purpose in examining the nature of the trustee's powers. Although the examination may have contributed to the court's decision to use the single transaction test, its main thrust seems to have been toward evaluation of business purpose. This conclusion is supported by the fact that the court, having already made the decision to use the single transaction test, went to great lengths to distinguish *Skemp* on the facts. The Fourth Circuit indicated that regardless of which test was used, the active nature of the trustee in *Skemp* indicated a business purpose, and the same result would be reached. 520 F.2d at 239.

[28] The full text of the trust agreement is printed in Perry v. United States, 376 F. Supp. 15, 17 (E.D.N.C. 1974).

disburse the income of the trust for the beneficiaries. The Fourth Circuit found that the trustee in *Perry* actually served no function other than to hold title and receive and disburse the rental payments.[29] Prior to the creation of the trust, the trustee had arranged the terms of the lease. However, since the lease committed all trust property back to the control of the settlor for the duration of the trust, the trustee was unable to exercise any management powers which might have been granted to him by the trust agreement. Because the trustee was denied the opportunity to manage actively the trust property, the Fourth Circuit concluded that the independence of the trustee was illusory and that no business purpose was served by the transaction.[30] Since the taxpayer created the situation himself, the court refused to consider the rental payments as a necessary business expense under § 162(a)(3).[31]

Although the Fourth Circuit in *Perry* ultimately concluded that the trustee's powers were illusory, the court seemed to imply that a business purpose might be found where the trustee had a significant function to serve in managing the trust.[32] In attempting to illustrate that identical results could be reached regardless of which test was employed, the Fourth Circuit partially distinguished two cases based on the more active role of the trustee.[33] To create such an active role for the trustee, tax planners in the Fourth Circuit might transfer more property to the trust than is required for the leaseback.[34] While a portion of the trust property is leased back to the settlor, the residue can be managed by the trustee. For example, if an office building is transferred to a trust and the taxpayer only needs to lease part of the space for his own business, the trustee could supervise the rental of the remaining office space. An alternative method to increase the active management of the trustee may be to negotiate the leaseback

[29] 520 F.2d at 238.

[30] *Id.*

[31] INT. REV. CODE OF 1954, § 162(a)(3).

[32] 520 F.2d at 238.

[33] *See* notes 34 and 35 *infra.* The Fourth Circuit in *Perry* further distinguished *Skemp,* and Brown v. Commissioner, 180 F.2d 926 (3rd Cir.), *cert. denied,* 340 U.S. 814 (1950), by noting that the taxpayer in those cases had not retained a reversionary interest in the trust property 520 F.2d at 239.

[34] The fact that more property is given to the trust than is leased back does not guarantee that the ensuing rental payments will be deductible. *See* Wiles v. Commissioner, 491 F.2d 1406 (5th Cir. 1974), *aff'g mem.* 59 T.C. 289 (1972). The Fourth Circuit, however, carefully explained that the same decision in *Skemp* could be reached when a single transaction test was applied, partially because more property was granted to the trust than was leased back. 520 F.2d at 239. *See also* 6 P-H 1975 FED. TAXES ¶ 60,483.

for a period shorter than the duration of the trust.[35] Once the lease expired, the trustee would be responsible for management of the trust property for the remainder of the trust term. Similarly, the trustee would then be responsible for finding a lessee for the duration of the trust. Either recourse would give the settlor-taxpayer a stronger argument that a business purpose exists because of the trustee's active role in managing the trust.

The adoption of the single transaction test by the Fourth Circuit in *Perry* sets a stringent standard for determining the deductibility of rental payments made to a Clifford trust following a leaseback to the settlor. Although the deduction was denied in *Perry*, the court indicated that an active independent trustee would help establish a valid business purpose. However, no court applying the business purpose test to the overall transaction has allowed the deductions, and the Fourth Circuit's ruling in *Perry* has seriously affected the use of the gift and leaseback transaction as a tax-saving tool.

C. The Fourth Circuit Takes a New Stance on Net Operating Loss Carryback

The Fourth Circuit recently departed from all prior precedent over the treatment to be given net operating loss deductions[1] carried back to years in which a corporation used the alternative tax computation for capital gains.[2] In *Mutual Assurance Society v. Commissioner*[3] the court paid exacting attention to the literal meaning of Internal Revenue Code § 172[4] and held that a taxpayer must take his entire taxable income into account in determining any excess loss carryback available for future years following the initial application of the loss carryback to the earliest year designated by § 172. The resulting conflict between the Fourth Circuit and other circuit courts[5]

[35] The Fourth Circuit distinguished Brown v. Commissioner, 180 F.2d 926 (3rd Cir.), *cert. denied*, 340 U.S. 814 (1950), partially on the basis that the leaseback was not for the duration of the trust. 520 F.2d at 239.

[1] INT. REV. CODE OF 1954, § 172.

[2] INT. REV. CODE OF 1954, § 1201(a).

[3] 505 F.2d 128 (4th Cir. 1974).

[4] INT. REV. CODE OF 1954, § 172.

[5] Foster Lumber Co. v. United States, 500 F.2d 1230 (8th Cir. 1974), *cert. granted*, 420 U.S. 1003 (1975); Olympic Foundry Co. v. United States, 493 F.2d 1247 (9th Cir. 1974); Chartier Real Estate Co. v. Commissioner, 52 T.C. 346 (1969), *aff'd* 428 F.2d 474 (1st Cir. 1970) (per curiam). Arguments in *Foster* were heard by the Supreme Court on November 12, 1975 but at the time of this writing no decision has been announced. 44 U.S.L.W. 3297 (U.S. Nov. 18, 1975) (No. 74-799).

has brought about the need for Supreme Court resolution of the problem presented in *Mutual Assurance.*[6]

The operating loss carryback provision[7] was promulgated to equalize tax treatment between corporations experiencing periodic income and corporations generating income at a steady rate.[8] If, in any particular year, a taxpayer sustains an operating loss greater than his income, the excess is classified as a net operating loss.[9] This net operating loss can be applied retroactively as a deduction in the third year prior to the loss year.[10] If the operating loss deduction is greater than the taxable income in the third year prior to the loss year, the excess is carried forward until depleted or until the fifth year following the year of net operating loss is reached.[11]

In *Mutual Assurance,* the 1969 operating loss was carried back to 1967,[12] a year in which Mutual Assurance's tax had been calculated under the alternative tax provision of § 1201(a).[13] Under the alternative tax provision, capital gain is separated from income and taxed at a different rate. Since Mutual Assurance's 1969 operating loss

[6] *See* Branda, *Net Operating Losses and Capital Gains—Some Bizarre Consequences of the Alternative Tax Computation,* 28 TAX LAW. 455 (1975); Nagel, *Planning to avoid Wastage of NOL carryovers: A lesson from* Chartier Realty, 42 J. TAXATION 26 (1975); Pratt & Scolnick, *The Net Operating Loss Deduction: Disagreement Among Circuit Courts Creates Confusion,* 53 TAXES 274 (1975).

[7] INT. REV. CODE OF 1954, § 172.

[8] H.R. REP. No. 855, 76 Cong., 1st Sess. 9-10 (1939), *reprinted* at 1939-2 CUM. BULL. 510-11. Congress hoped that the existence of the carryover provision would promote new investment since it granted a deduction for losses which commonly occur in the first years of a company's operations. *Accord,* Mutual Assurance Society v. Commissioner, 505 F.2d at 137; Chartier Real Estate Co. v. Commissioner, 52 T.C. at 357.

[9] INT. REV. CODE OF 1954, § 172(c).

[10] INT. REV. CODE OF 1954, § 172(b)(1)(A)(i).

[11] INT. REV. CODE OF 1954, § 172(b)(1)(B).

[12] The 1969 operating loss was initially carried back to 1966, the third year prior to the loss year. However, the taxpayer had no taxable income in 1966 so the entire carryback amount was available in 1967. 505 F.2d at 130.

[13] INT. REV. CODE OF 1954, § 1201(a). The alternative tax of § 1201(a) is computed in a two-step process. In the first step, the taxpayer's gross income is reduced by deductions, including operational loss carryback, and the amount of taxpayer's capital gain. The resulting figure is the taxpayer's ordinary taxable income and a partial tax is levied on this amount under Internal Revenue Code § 11. The second step of § 1201(a) assesses a flat 30% tax on the entire amount of the capital gains. The alternative tax of § 1201(a) is mandatory if it assesses a tax lower than that calculated by the regular methods under §§ 11, 511, 821, 831. INT. REV. CODE OF 1954, § 1201(a).

For 1967, the year in which the *Mutual Assurance* controversy arose, the second step of § 1201(a) assessed only a 25% rate on capital gains. INT. REV. CODE OF 1954, § 1201(a)(1).

carryback exceeded its 1967 ordinary income,[14] the question contested was the computation of the excess operating loss carryback available for use in future years.

The resolution of the issue in *Mutual Assurance* depended on the interpretation of a phrase in § 172(b)(2).[15] That section defines the amount of operating loss carryback eligible to be carried forward as the "excess, if any, of the amount of such loss over the sum of the taxable income for each of the prior taxable years to which such loss may be carried."[16] The Commissioner argued that the words "taxable income" meant taxable income as defined in § 63(a)[17] which includes capital gain as well as ordinary income. Conversely, the taxpayer argued that the phrase meant taxable income to which the operating loss carryback could actually be applied,[18] that is, only ordinary income. Thus, the essential controversy involved the proper statutory construction of § 172(b)(2).[19]

The Fourth Circuit held that, for a taxpayer employing the alternative tax computation, the words "taxable income" in § 172(b)(2) included capital gain as well as ordinary income. Examining the statutory language, the court concluded that the phrase "to which such loss may be carried" in § 172(b)(2) did not modify the crucial term "taxable income." Instead, the court applied the basic § 63 definition[20] of taxable income to § 172(b)(2). Section 63 defines taxa-

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[14] The total amount of the 1969 loss was $83,059.04, while the net ordinary income for 1967 was $72,575.10. The taxpayer contended that the excess of $10,483.94 was available for a deduction in 1968. 505 F.2d at 129.

[15] INT. REV. CODE OF 1954, § 172(b) provides in pertinent part:

> (2) AMOUNT OF CARRYBACKS AND CARRYOVERS. [T]he entire amount of the net operating loss for any taxable year (hereinafter in this section referred to as the "loss year") shall be carried to the earliest of the taxable years to which . . . such loss may be carried. The portion of such loss which shall be carried to each of the other taxable years shall be the excess, if any, of the amount of such loss over the sum of the taxable income for each of the prior taxable years to which such loss may be carried.

[16] *Id.*

[17] INT. REV. CODE OF 1954, § 63(a). Taxable income is defined in terms of gross income, which specifically includes capital gain. INT. REV. CODE OF 1954, § 61(a)(3).

[18] If, in an alternative tax computation under Internal Revenue Code § 1201(a), *see* note 13 *supra*, a taxpayer's deductions exceed the amount of his ordinary income in step one of the computation, the excess is not applied to reduce the amount of capital gain in step two which is subject to the flat 30% tax. Weil v. Commissioner, 229 F.2d 593 (6th Cir. 1956); Rev. Rul. 247, 1956-1 CUM. BULL. 383. In effect, this excess of net operating loss carryback over ordinary income has not affected the tax computation.

[19] INT. REV. CODE OF 1954, § 172(b)(2). *See* note 15 *supra*.

[20] *See* note 17 *supra*.

ble income as gross income, which includes capital gain, minus deductions. The Fourth Circuit concluded that the reference to "taxable income" in § 172(b)(2) was meaningless unless the § 63 definition was applied.[21]

Under this construction of the statute, the excess of operating loss carryback over ordinary income will not automatically be available as a carryover to future years for a taxpayer employing the alternative method of tax computation. Instead, operating loss carryback must exceed not only ordinary income, but capital gain as well. To the extent that the excess of operating loss carryback over ordinary income is absorbed by the capital gain included in taxable income under § 172(b)(2), it produces no tax benefit for the taxpayer.[22]

The Fourth Circuit also relied upon legislative history to support its holding in *Mutual Assurance.* The court stated that the tax equalization goal[23] of carryback legislation would substantially be achieved by its decision.[24] Although the taxpayer might not benefit from its total operating loss carryback, corporations with periodic earnings would receive tax treatment closer to that of corporations experiencing steady earnings. In reviewing the legislative history,[25] the Fourth

[21] To support its conclusion, the Fourth Circuit also compared Internal Revenue Code § 172(b)(2) to Internal Revenue Code § 172(d)(2)(B) which concerns noncorporate taxpayers. The court found that taxable income as used in that section included capital gain and inferred that Congress would not have intended two concepts of taxable income to exist in the same code section. 505 F.2d at 129-30.

[22] Nagel, *Planning to avoid wastage of NOL carryovers; A lesson from* Chartier Realty, 42 J. TAXATION 26, 28 (1975).

[23] *See* text accompanying note 8 *supra.*

[24] 505 F.2d at 137-38.

[25] The first carryback provision was introduced in the Revenue Act of 1918. Act of Feb. 24, 1919, 65th Cong., 3d Sess., Ch. 18, § 204, 40 Stat. 1060. An alternative tax was enacted in 1921 and modified in 1924. Act of Nov. 23, 1921, 67th Cong., 1st Sess., Ch. 136, § 206, 42 Stat. 232; Act of June 6, 1924, 68th Cong., 1st Sess., Ch. 234, § 208(a)(5), 43 Stat. 262. Corporate taxpayers, however, did not receive special treatment for capital gains until 1942. Act of Oct. 21, 1942, 77th Cong., 2d Sess., Ch. 619, § 150, 56 Stat. 843. Although the combined carryback and alternative tax provisions operated for a short time to provide tax benefit for each dollar of operational loss which was depleted, the provisions were abolished in 1933 and 1934 respectively. Act of June 16, 1933, 73d Cong., 1st Sess., Ch. 90, § 218(a), 48 Stat. 209; Act of May 10, 1934, 73d Cong., 2d Sess., Ch. 277, § 117, 48 Stat. 714. The predecessors of the current alternative tax and carryback provisions were passed in 1938 and 1939 with modifications. Act of May 28, 1938, 75th Cong., 3d Sess., Ch. 289, § 117(c), 52 Stat. 501; Act of June 29, 1939, 76th Cong., 1st Sess., Ch. 247, § 211, 53 Stat. 867. Excess operating loss could no longer be deducted from capital gain in the carryback year. *See* note 18 *supra.* Whether the excess of operating loss carryback over ordinary income could be absorbed by capital gain without yielding tax benefit to the taxpayer was also uncertain. 505 F.2d at 136-38.

Circuit traced the development of both the alternative tax and the loss carryback tax provisions. The court noted that at one time the combined carryback and alternative tax provisions had the same effect as the interpretation argued by the taxpayer in *Mutual Assurance.*[26] Congress subsequently modified both the carryback and alternative tax provisions,[27] and failed to require clearly that the full amount of operating loss carryback always affect the computation of the alternative tax. The Fourth Circuit inferred that Congress no longer intended that taxpayers necessarily benefit from each dollar of operating loss carryback.[28] Thus, the Fourth Circuit justified its statutory interpretation as being in substantial compliance with the legislative goal.

The decision in *Mutual Assurance* departs from all previous cases.[29] The Fourth Circuit specifically rejected *Chartier Real Estate Co. v. Commissioner,*[30] the first case allowing the excess of operating loss carryback over ordinary income to be deducted in the following tax year. The *Chartier* court held that the phrase "to which such loss may be carried" applied not only to "each of the prior taxable years" but to "taxable income" as well.[31] Under the *Chartier* court's interpretation, a taxpayer using the alternative tax computation would only apply operating loss carryback to offset ordinary income.[32] This interpretation prevents the excess of operating loss carryback over ordinary income from being absorbed by capital gain in an alternative tax computation. In rare situations, the *Chartier* interpretation of § 172(b) (2) can cause unfair results to taxpayers,[33] but it generally

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[26] 505 F.2d at 138. The court observed that between 1924 and 1934 the excess operating loss carryback could be used to offset capital gain in the carryback year. Thus, the taxpayer benefited from his entire operating loss carryback.

[27] *See* note 25 *supra.*

[28] 505 F.2d at 138.

[29] *See* Foster Lumber Co. v. United States, 500 F.2d 1230 (8th Cir. 1974), *cert. granted,* 420 U.S. 1003 (1975); Olympic Foundry Co. v. United States, 493 F.2d 1247 (9th Cir. 1974); Chartier Real Estate Co. v. Commissioner, 52 T.C. 346 (1969), *aff'd,* 428 F.2d 474 (1st Cir. 1970) (per curiam). *See also* Data Products v. United States, 74-2 U.S. Tax Cas. § 9759 (C.D. Cal. 1974), *aff'd mem.,* (9th Cir. Dec. 27, 1974), *petition for cert. filed,* 44 U.S.L.W. 3010 (U.S. Feb. 10, 1975) (No. 74-996); Continental Equities, Inc. v. Commissioner, 33 CCH Tax Ct. Mem. 812 (1974); Naegele v. United States, 383 F. Supp. 1041 (D.Minn. 1973).

[30] 428 F.2d 474 (1st Cir. 1970), *aff'g* (per curiam) 52 T.C. 346 (1969).

[31] INT. REV. CODE OF 1954, § 172(b)(2). *See* note 15 *supra.*

[32] *See* note 18 *supra.*

[33] *See,* Lone Manor Farms, Inc., 61 T.C. 48 (1974), *aff'd mem.,* (3d Cir. Jan. 27, 1975). In *Lone Manor,* the net operating loss carryback for the taxpayer was so great that the regular method of tax computation was lower in the carryback year and therefore compulsory. INT. REV. CODE OF 1954, § 1201(a). *See* note 13 *supra.* This switch

avoids the extreme situation, allowed by *Mutual Assurance*, in which capital gain absorbs part of the operating loss carryback deduction to which the taxpayer is otherwise entitled. Thus, the *Chartier* reasoning is generally more consistent with the expressed legislative intent[34] than the *Mutual Assurance* holding because it allows a taxpayer to spread his operating loss further and thus achieve a more substantial economic parity with the steady income taxpayer.

However, commentators have indicated that both constructions of § 172(b)(2) are strained.[35] While the *Chartier* interpretation alters the normal meaning and application of the word "carried", the *Mutual Assurance* interpretation draws an analogy to a noncorporate code section in concluding that the § 63 definition of taxable income is applicable to § 172(b)(2). Although congressional action to eliminate the ambiguity of § 172(b)(2) has been urged,[36] the Supreme Court has

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in the tax computation method resulted in the depletion of taxpayer's operating loss in the carryback year with minimal tax savings. Had the operating loss carryback been slightly smaller, the alternative tax computation would still have been employed and taxpayer would have retained a large operating loss carryback for future use. *See,* Nagel, *Planning to avoid wastage of NOL carryovers: A lesson from* Chartier Realty, 42 J. TAXATION 26, 27 (1975).

[34] *See* text accompanying note 8 *supra.*

[35] The obvious manipulation involved in reaching the *Chartier* interpretation of § 172(b)(2), *see* text accompanying notes 30-32 *supra,* has induced some commentators to accept the *Mutual Assurance* view as a more literal interpretation. *See* Nagel, *Planning to avoid wastage of NOL carryovers: A lesson from* Chartier Realty, 42 J. TAXATION 26, 28 (1975); Pratt & Scolnick, *The Net Operating Loss Deduction: Disagreement Among Circuit Courts Creates Confusion,* 53 TAXES 274, 278 (1975).

In addition, another circuit court has followed the *Mutual Assurance* reasoning in holding against a noncorporate taxpayer on the same issue. Axelrod v. Commissioner, 507 F.2d 884 (6th Cir. 1975), *rev'g* 32 CCH Tax Ct. Mem. 885 (1973). Although mentioning the recent decision in *Mutual Assurance,* the *Axelrod* court relied heavily on Treasury Regulation § 1.172-5 pertaining only to noncorporate taxpayers. 507 F.2d at 888-89. Therefore, the value of the *Axelrod* decision in support of the *Mutual Assurance* holding involving corporations is questionable.

The *Mutual Assurance* decision has also been criticized for its analysis of § 172(b)(2). *See* Branda, *Net Operating Losses and Capital Gains—Some Bizarre Consequences of the Alternative Tax Computation,* 28 TAX LAW. 455, 464-65 (1975). The Fourth Circuit relied strongly upon a determination that taxable income for noncorporate taxpayers does not include capital gain. The court reached that conclusion upon inspection of § 172(b)(2) and § 172 (d)(2)(B). Having made that determination, the court concluded that the § 63 definition of taxable income must apply to corporate taxpayers under § 172(b)(2). However, since § 172(d)(2)(B) expressly excludes corporate taxpayers, the value of a comparison with § 172(b)(2) is questionable, and one commentator has expressed support for the *Chartier* interpretation. Branda, *Net Operating Losses and Capital Gains—Some Bizarre Consequences of the Alternative Tax Computation,* 28 TAX LAW. 455, 470 (1975).

[36] One commentator has called for legislation which would lead to an equitable

already granted certiorari and heard arguments in a case which relied upon the *Chartier* rationale.[37] Hopefully, the Court's forthcoming opinion will follow the *Chartier* reasoning. As neither of the statutory constructions are convincing, the *Chartier* interpretation is preferable since it more nearly coincides with the expressed goal of carryback legislation.[38]

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result for the taxpayer. Suggestions include allowing operating loss carryback to offset capital gain and making the alternative tax computation permanent once originally made. *See* Nagel, *Planning to avoid wastage of NOL Carryovers; A lesson from* Chartier Realty, 42 J. TAXATION 26, 29 (1975).

[37] Foster Lumber Co. v. United States, 500 F.2d 1230 (8th Cir. 1974), *cert. granted,* 420 U.S. 1003 (1975). Arguments in *Foster* were heard by the Supreme Court on November 12, 1975, but at the time of this writing no decision has been announced. 44 U.S.L.W. 3297 (U.S. Nov. 18, 1975) (No. 74-799).

[38] *See* text accompanying note 8 *supra.*