
Jerome J. Kavulich
NOTES


I. INTRODUCTION

A sale-leaseback, in its simplest form, involves an owner of property selling that property outright and simultaneously leasing it back from the purchaser, frequently with renewal or repurchase provisions. The term, however, has become a catch-all description for numerous transactions entered into for various reasons. Many of these transactions are far more complex than the simple two-party sale-leaseback. In Frank Lyon Co. v. United States, the complexities included the involvement of three parties and the intertwining of numerous terms and conditions. When the United States Supreme Court granted certiorari, it appeared ready to an-


2. The purchaser-lesser can be a single investor or a syndicate of investors. These realty syndicates may take the form of corporations, unincorporated associations, limited partnerships, or trusts. See Rabinowitz, Realty Syndication: An Income Tax Primer for Investor and Promoter, 29 J. Tax. 92 (1968); Robertson, supra note 1.

The Tax Reform Act of 1976, Pub. L. No. 94-455, 90 Stat. 1520, has affected these shelters. Besides limiting the availability of tax shelter techniques, the Act has affected depreciation deductions through recapture provisions and interest deductions by restricting the deductability of prepaid interest. For a complete analysis of the effects of the Tax Reform Act of 1976 on real estate tax shelters, see Dailey & Gaffney, Anatomy of a Real Estate Tax Shelter: The Tax Reform Scalpel, 55 Taxes 127 (1977). For simplicity, this article will limit its analysis to the single investor.


6. See notes 10-16 infra and accompanying text.

7. 429 U.S. 1089 (1977). The Supreme Court granted certiorari to resolve an
nounce comprehensive, workable guidelines to facilitate tax planning for sale-leasebacks. Instead, the Court has handed down a multi-faceted opinion upholding the particular sale-leaseback in question, but rendering the future treatment of these transactions unpredictable.

The following discussion describes the relative position of the Lyon transaction in the broad spectrum of sale-leasebacks. It examines the conceptual difficulties which have hindered earlier attempts to establish guidelines for the tax treatment of sale-leasebacks, questions the Supreme Court's analysis of the transaction, and suggests future effects of Lyon on these transactions.

II. THE LYON CASE

In April 1965, the Worthen Bank and Trust Company (Worthen) planned construction of a multi-story banking and office facility to serve as its headquarters. Various state and federal regulations prohibited conventional financing. Worthen therefore entered into a sale-leaseback arrangement with the Frank Lyon Company (Lyon), the taxpayer, who took title to the facility and leased

8. 435 U.S. at 563-64. Worthen originally desired to finance, build, and itself own the proposed facility by selling debentures and acquiring the capital stock of a wholly owned subsidiary which, upon receipt of the title to the facility, would raise the remaining funds by a conventional mortgage. Arkansas banking laws imposed a ceiling on interest-payable debentures rendering the debentures unattractive in the then existing financial market. Additionally, since the proposed investment in the banking facility was in excess of 40% of Worthen's capital stock and surplus, the Arkansas State Bank Department and the Federal Reserve System refused to ratify the plan as required by 12 U.S.C. § 371d (1976), Banks and Banking, 12 C.F.R. § 265.2(f)(7) (1978), and Ark. Stat. Ann. § 67-547.1 (Supp. 1977).

9. Worthen negotiated with several interested investors, including Lyon. Lyon was a closely held corporation engaged in the distribution of electrical products. Worthen selected Lyon as the investor because of its acceptance of Worthen's counterproposal which incorporated the best features of the proposed offers. 435 U.S. at 565.
it back to the bank for its long term use.\(^{10}\) As the investor, Lyon

Frank Lyon, chairman of the board of the taxpayer company, served on Worthen's board and had substantial business relations with Worthen. Normally, such a relationship would indicate a sham transaction. However, the Court's doubts as to the parties' intent to deal at arm's length were discharged by the uniqueness of the transaction to Worthen, and the fact that Worthen opened the negotiations to any interested investor. See id. at 581-82.

10. The transfer of title and leaseback involved a ground lease, a sales agreement, and a building lease. Worthen as the owner of the site, leased the site to Lyon for a period of 76 years and 7 months. The first 19 months equaled the estimated construction period of the facility. The first 26 years and 7 months, excluding the construction period, constituted the period of the mortgage. During that period the rents amounted to only $50 per year. The parties favored the minimal ground rents, since increased ground rents would require an equal increase in building rents paid by Worthen, resulting in a wash item. Beyond the initial rental period, however, the rents sharply increased, ranging from $100,000 to $250,000 per year over the next 50 years. Id. at 565.

Under the sales agreement, Worthen agreed to sell the building to Lyon piece by piece as it was constructed for a total price not to exceed $7,640,000. This procedure allowed both parties to retain a substantial sales tax saving since by Arkansas law, purchases of material by a national bank were exempt from the state sales tax. Also, the piecemeal sales of the building constituted sales of real estate and were exempt from the sales tax. See id. at 566 n.2. Since the piecemeal sale of the building has no effect on the federal tax treatment of the parties, this article treats the transaction as requiring the sale of the completed facility.

The building lease constituted a net lease which, by definition, imposes upon Worthen as a lessee the responsibilities for all the expenses, risks, and liabilities associated with the facility, excluding wear and tear. Id. at 567. A summary of the lease terms may be found in Frank Lyon Co. v. United States, 536 F.2d 746, 749-50 (8th Cir. 1976). Worthen also had an option to repurchase at various times at stated prices or to renew the lease up to eight additional terms at five-year intervals. 435 U.S. at 566-67.

The combination of the ground lease and the building lease created a time gap during which Lyon would be without Worthen as a tenant, but would still be leasing the site of the facility from Worthen under the terms of the ground lease. This "shirt tail" period could, depending upon Worthen's exercise of its five-year renewal options, extend from a minimum of 10 years to a maximum of 50 years. [75-year ground lease—(25-year primary term of lease + total renewal period opted by Worthen) = the "shirt tail" period]. During this period, Lyon still had to satisfy the rental obligations to Worthen on the ground lease. Lyon could offset the ground rent only by acquiring a lessee willing to pay sufficient rents to defray ownership expenses as well as ground rent. Thus, if Worthen refused to renew or purchase and Lyon failed to secure another lessee, Lyon would bear the risk of being left with an empty, non-income-producing facility.

The agreements left unclear who owned the facility upon the expiration of the ground lease. The Court of Appeals for the Eighth Circuit noted that the retention of the land reserved to Worthen "substantial control over the ultimate disposition of the building should the bank forgo its option privileges." See 536 F.2d at 752-53 n.6. If Lyon retained control at the end of the ground lease period, it would have to either sell the building to Worthen, renegotiate a building lease with Worthen, purchase the site, or renegotiate the ground lease. Otherwise, Lyon would not be able to use
supplied an out-of-pocket at-risk investment of $500,000. This investment could return up to 6% per year, depending upon Worthen's exercise of the lease renewal and repurchase options. Worthen obtained for Lyon interim construction financing from the First National City Bank of New York (Citibank). After approving Lyon as the investor, New York Life Insurance Company (New York Life) provided permanent long-term financing for the project. Upon completion of the facility, Lyon used the New York Life funds to discharge the interim construction loan from Citibank, thus eliminating Citibank from the transaction.

The series of complementary and interlocking agreements among the parties obligated Worthen to pay rent equal to the principal and interest payments of Lyon's mortgage. Worthen also possessed an option to repurchase the facility at stipulated times with stated prices equal to the then unpaid balance of Lyon's mortgage plus the initial $500,000 equity with 6% return. In 1969, the

the building without trespassing on Worthen's property. The Supreme Court, however, failed to comment on the issue, concentrating on the aspects of the transaction within the ground lease period.

11. The total purchase price of the facility amounted to $7,640,000. Since New York Life Insurance Company had agreed to permanent financing of $7,140,000, Lyon was required by the terms of the agreement to supply the difference of $500,000 as equity. During negotiations, Worthen had proposed that the investor selected for the transaction supply the equity. See note 9 supra and accompanying text. Lyon agreed to the counterproposal and supplied the necessary funds required by Worthen to complete the financing of the new building. See also Rosenberg & Weinstein, Sales-Leasebacks: An Analysis of these Transactions after the Lyon Decision, 45 J. Tax. 146 (1976).

12. Over the primary 25-year term, Worthen had the option to buy the facility at specific times and prices. In addition to including the unpaid balance of the underlying building mortgage, each repurchase figure included the $500,000 personal investment plus 6% return. 435 U.S. at 567.

13. Id.

14. New York Life agreed to purchase Lyon's $7,140,000 6% 25-year secured note which was issued upon completion of the building. The mortgage was secured by a first deed of trust executed by the taxpayer and Worthen, which conveyed to New York Life title to the land and facility. As additional security, Lyon assigned its interest in the building lease and ground lease to New York Life. In a separate agreement with New York Life, Worthen consented to the assignment and agreed not to terminate the lease during the 25-year period of the mortgage. 435 U.S. at 567-68. See also Frank Lyon Co. v. United States, 536 F.2d 746, 749 (8th Cir. 1976).

15. 435 U.S. at 568.

16. Total rent for the building over the primary term of the lease was $14,989,767.24, which equaled the principal and interest that would amortize the $7,140,000 mortgage loan to Lyon for the same period. The lease terms included options to repurchase the building at the end of 11, 15, 20, and 25 years at prices equal to Lyon's investment of $500,000 at 6% return plus the sum of the unpaid balance of the New York Life mortgage. Id. at 566-67.
year the building was completed, rent began to accrue to Lyon from Worthen. While Lyon included the rent as income,\textsuperscript{17} it also claimed deductions for depreciation\textsuperscript{18} on the Worthen building, for interest paid on the interim and permanent mortgage loans,\textsuperscript{19} and for other expenses incurred in the construction of the building.\textsuperscript{20} The full tax benefits of ownership therefore accrued to Lyon as a result of a relatively small out-of-pocket investment.

On audit of Lyon's 1969 return,\textsuperscript{21} the Commissioner of Internal Revenue disallowed the deductions, asserting that as a matter of economic substance for federal tax purposes, Worthen retained the real ownership in the building.\textsuperscript{22} The Commissioner assessed a deficiency on Lyon's federal income tax,\textsuperscript{23} which Lyon paid. Upon denial of its claim for a refund, Lyon initiated suit in federal dis-

At the end of the primary term, if Worthen desired to renew the lease, the rents were reduced by approximately 50\% to $300,000 per year. These rents were proportionately washed by the ground rents due from Lyon. Lyon's recoupment of its investment, however, rested on its ability to rent the facility for the "shirt tail" period. See note 10 \textit{supra} and accompanying text. If Lyon failed to realize sufficient rental during the period, the investment return would fall proportionately. See Zarrow \& Gordon, \textit{Supreme Court's Sale-Leaseback Decision in Lyon Lists Multiple Criteria}, 49 J. TAX. 42 (1978).

\begin{enumerate}
\item \textsuperscript{17} I.R.C. \S 61.
\item \textsuperscript{18} Id. \S 167.
\item \textsuperscript{19} Id. \S 163.
\item \textsuperscript{20} 435 U.S. at 568.
\item \textsuperscript{21} Worthen moved into the facility on December 1, 1969.
\item \textsuperscript{22} The gist of the Commissioner's argument was that the sale-leaseback in question constituted a financing transaction in which Lyon loaned Worthen $500,000 and acted as a conduit for the transmission of principal and interest from Worthen to New York Life. \textit{Id.} at 569.
\item \textsuperscript{23} If the transaction constituted a financing technique which lacked substance, the rent would not be included in Lyon's gross income, nor would the deductions related to the facility be allowed. On Lyon's return, however, because the deductions exceeded Lyon's rental income reported, the Service increased Lyon's reported income by $497,219.18. This created a tax deficiency of $236,596.36 which together with interest of $43,790.84 resulted in an assessment of $280,387.20 for the year of 1969. \textit{Id.}
\end{enumerate}

Most of this assessment resulted from expenses accrued during the construction of the facility, amounting to $451,666.75. The deductions which are important here are the depreciation deduction of $51,618.79 and the interest deduction from the mortgage of $40,162.50 taken by Lyon for December 1969. These deductions surpassed the rental income for the same period of $48,527.01, thus creating a tax loss. If the Commissioner had allowed the deductions, Lyon would have received favorable tax treatment. The deductions would have offset reported income unrelated to the sale-leaseback transaction to the extent of the tax loss. For an analysis of the tax savings, see Gallagher, \textit{Tax Consequences of a Leveraged Lease Transaction}, 52 TAXES 356 (1974); Robertson, \textit{supra} note 1. \textit{But see} 435 U.S. at 580 n.15.
In a memorandum opinion the court ruled that the claimed deductions were allowable. The Court of Appeals for the Eighth Circuit reversed, holding that the burdens, benefits, and risks which Lyon had incurred were too insubstantial to establish ownership status for tax purposes. After granting certiorari, the Supreme Court reversed, holding that Lyon retained significant and genuine attributes of a lessor which gave Lyon a depreciable interest in the facility.

III. The Court's Analysis

Because the repurchase options and lease renewals permitted Lyon to recover its $500,000 investment with up to 6% return, the Service argued that the transaction represented a financing scheme without sufficient economic substance to constitute a depreciable interest in the facility. The Service claimed as controlling precedent an earlier Supreme Court case, Helvering v. F & R Lazarus and Co. In Lazarus the taxpayer had transferred properties to a trust, and then leased them for 99 years with repurchase options at stated scheduled prices. The taxpayer as lessee sought the depreciation deductions by arguing that the transaction was in reality a mortgage to secure a loan and, therefore, retained the right to take the deductions. The Commissioner disallowed the deductions on the grounds that the right to take depreciation followed legal title. Completely disregarding the lessor as the owner, the Court permitted the deductions by treating the transaction as a financing transaction.

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The taxpayer-lessee in Lyon, however, had title to the depreciable facility and argued that it possessed sufficient incidents of ownership in the building to render
trust and released them, a situation unlike the Lyon sale-leaseback which involved an independent third party, the mortgagee.\textsuperscript{31} The Court held that this distinction, as well as the unavailability of the simpler two-party arrangement by virtue of the state and federal banking restrictions,\textsuperscript{32} removes Lyon from the controlling authority of Lazarus.\textsuperscript{33} Lazarus would apply only if Worthen had been able to directly secure the mortgage agreement with New York Life and to receive the $500,000 loan from Lyon.\textsuperscript{34}

The majority's inquiry into the Worthen-Lyon transaction focused on whether the substance\textsuperscript{35} of the entire transaction amounted to an "elaborate financing scheme" or a bona-fide transfer of title sufficient to give the taxpayer-lessee a depreciable interest in the building.\textsuperscript{36} Justice Blackmun, writing for the majority, after stressing that "no simple device [was] available to peel away the form of this transaction and to reveal its substance,"\textsuperscript{37} emphasized that the agreements in their final forms imposed primary liability on Lyon.\textsuperscript{38} Various contingencies surrounding Worthen's

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\textsuperscript{31} See note 14 supra and accompanying text.

\textsuperscript{32} 435 U.S. at 575. See also note 8 supra and accompanying text.

\textsuperscript{33} It should be noted that Lazarus still stands as controlling precedent in simpler two-party transactions. The transaction need only possess the necessary economic substance to render the lessor the owner for tax purposes.

\textsuperscript{34} 435 U.S. at 575-76.

\textsuperscript{35} The Court's analysis rests on the established principle that the "objective economic realities" of a transaction rather than its particular form govern for tax purposes. The Court noted, "In the field of taxation, administrators of the laws, and the courts, are concerned with substance and realities, and formal written documents are not rigidly binding." \textit{Id.} at 573 (quoting Helvering v. F. & R. Lazarus & Co., 308 U.S. 252, 255 (1939)). If a genuine multiparty transaction exists, the fact that it constitutes a sale-leaseback will not operate in itself to deny proper tax benefits for the taxpayer. \textit{See id.} at 584 n.19.

\textsuperscript{36} \textit{Id.} at 573.

\textsuperscript{37} \textit{Id.} at 576.

\textsuperscript{38} \textit{Id.} at 576-77. Justice Blackmun explained that the effect of this liability on Lyon was not just the abstract possibility of an extraordinary circumstance occurring as to prevent Worthen from making its rental payments. The realities of the situation placed the liability on Lyon's shoulders "for all the world to see," while Lyon as a continual enterprise "exposed its very business well-being to this real and substantial risk." \textit{Id.} at 577.

Lyon did not exist as a corporation established by Worthen or even financed to any degree by Worthen, but prevailed as an independently owned business entity interested in investment of its funds. The transaction thus appeared to be conducted at arm's length. \textit{See} note 9 supra and accompanying text.
exercise of its options to repurchase or renew made Lyon’s recovery of its investment with a guaranteed return highly improbable. Additionally, state and federal banking statutes had barred Worthen from entering into the specific two-party financing agreement which the Service urged to be the true substance of the transaction. To the Court, these factors indicated a transaction which possessed far more substance than a mere mortgage agreement between Worthen and Lyon and a loan from Lyon to Worthen.

The Court, however, acknowledged that favorable tax considerations, measured by the benefits of the depreciation deductions on the facility, influenced Lyon’s decision to participate in the transaction. Significant tax motivations and the acceptance of a lower economic return because of tax benefits did not nullify the form of the transaction where the transaction itself possessed significant economic substance. Lyon conceded a lower rate of return on its investment in order to obtain the anticipated benefit of depreciation deductions. To disallow the tax benefits simply because the otherwise legitimate business transaction rested on such tax advantages, would destroy the business purposes of the transaction. As long as Lyon possessed a sufficient depreciable interest

39. The rents due at the end of the primary term of the lease after the mortgage has been paid fall short of the promised 6% return which, as the Service urges, Lyon is guaranteed. The assured return only exists if Worthen exercises its options to purchase. Whether Worthen will exercise any of its options totally depends on the external contingencies of the value of real estate, the cost of money, and Worthen’s capital structure at the time the options are exercisable. Thus, because of the contingent nature of the options and the lack of any economic compulsion on the part of Worthen to exercise any of the options, the return of the investment with guaranteed interest cannot be considered in determining Lyon’s depreciable interest. 435 U.S. at 579-80.

40. Id. See also note 8 supra and accompanying text.

41. 435 U.S. at 580. For an analysis of those favorable tax benefits akin to this type of sale-leaseback, see notes 71-73 infra.

42. 435 U.S. at 580 (citing Commissioner v. Brown, 380 U.S. 503, 579-80 (1965) (Harlan, J., concurring)).


44. Lyon accrued no net profit from the rents since the rents equaled the amount due on the amortized loan from New York Life. To Lyon, the zero cash flow to him could be justified only by the tax benefits from the transaction. Without the tax benefits, Lyon’s purpose for entering the transaction would be senseless, since his expected return would no longer exist.

45. Generally, tax avoidance lacks relevance in determining the allowance of those contemplated tax benefits. See 435 U.S. at 575 (quoting Commissioner v. Duberstein, 363 U.S. 278, 286 (1960)). But, where the transaction incorporates tax
in the property, the Court found that the Service could not disallow the deductions.

The nature of the Worthen-Lyon transaction indicated that there existed no simple owner of the building. Justice Blackmun nevertheless determined that Lyon committed its capital to the building. Therefore, Lyon was permitted to claim both depreciation deductions for the consumption of that capital and interest deductions on the obligations stemming from the facility. Finally, after an analysis of the substance and economic realities of the transaction, as well as the status of all the parties, the Court held that since Lyon as the lessor retained "significant and genuine attributes of the traditional lessor status," the Commissioner was compelled to honor the form adopted by the parties.

In his dissent, Justice Stevens disputed the relevance of the factors relied on by the majority to establish Lyon's depreciable interest. Stevens contended that the existence of a true lessor-lessee relationship depended on the present value of the lessor's reversionary estate to the lessor. The lessor, through his remaining interests upon the initiation of the lease, must participate in the risks and benefits of property ownership to render his interest in the property depreciable.

benefits without the presence of a distinct business purpose beyond those benefits, the transaction assumes a sham characteristic. The tax benefits may be a motivating factor for one to become a party to a transaction, but those tax benefits cannot be the dominating reason for the transaction. Otherwise, the "business purpose doctrine" will require that the tax benefits be disallowed. See Knetsch v. United States, 364 U.S. 361 (1960); Goldstein v. Commissioner, 364 F.2d 734 (2d Cir. 1966), aff'd, 44 T.C. 284 (1965), cert. denied, 385 U.S. 1005 (1967). See also Young, The Role of Motive in Evaluating Tax Sheltered Investments, 22 TAX LAW. 275, 277-86 (1969).

In Lyon, the Court failed to address the issue of a business purpose. The Court did recognize, however, that Lyon's principal motivation was diversification. See 435 U.S. at 582. The presence of this fact thus eliminated the necessity for the Court to deal with the issue.

46. Id. at 581-83.
47. Justice Blackmun stated as his holding, here, as here, there is a genuine multi-party transaction with economic substance which is compelled or encouraged by business or regulatory realities, is imbued with tax-independent considerations, and is not shaped solely by tax-avoidance features that have meaningless labels attached, the Government should honor the allocation of rights and duties effectuated by the parties.
Id. at 583-84.
48. Id. at 584 (Stevens, J., dissenting). This interest consisted of the power of the lessor to assume complete control over the facility upon expiration of the lessee's leasehold interest.
49. Id.
the repurchase options, if exercised, guaranteed Lyon his equity investment with 6% return plus the balance of the New York Life mortgage.\textsuperscript{50} Yet, the value of Lyon's reversionary interest might fluctuate in relation to the fair market value of the building. But, because of the return, Lyon's position upon exercise of the options would be no better or worse than at the outset of the transaction.

On the other hand, Worthen's tender, upon repurchase, of the remaining rental payments plus Lyon's investment equity with accrued return would, in reality, permit it to receive the entire interest in the facility without payment to Lyon for its reversionary interest. This power in Worthen attaches a zero value\textsuperscript{51} to Lyon's reversion over the primary term of the lease. The existence of the zero value interest, according to Justice Stevens, prohibited Lyon from participating in the risks and benefits of ownership and thus from being characterized as the owner of the facility.\textsuperscript{52}

Justice Stevens' argument relies on the exercise of a power of the lessee, even though at the time of the agreement's formulation the exercise of that power remains uncertain. Worthen was under no economic compulsion to exercise any of the four repurchase options.\textsuperscript{53} Similarly, although exercise was completely controlled by Worthen's discretion, the various contingencies\textsuperscript{54} surrounding the exercise of the repurchase options made such an event improbable at the outset of the lease term. Until such exercise became probable, a sufficient lessor-lessee relationship existed\textsuperscript{55} to give

\textsuperscript{50} See note 12 \textit{supra}.

\textsuperscript{51} 435 U.S. at 585-86 (Stevens, J., dissenting). If Worthen should exercise its option to repurchase in the 11th year, Lyon would receive merely the remainder of the mortgage loan to Lyon from New York Life plus the initial $500,000 equity with 6% return. \textit{See} note 12 \textit{supra}. At that point, Lyon would relinquish its rights over the remaining rental period and its reversionary interest for a figure equal only to the total rent due on the remaining rental period plus the investment with interest. Since no portion of the option price is attributed to the lessor's reversion, the interest is said to have zero-value.

\textsuperscript{52} 435 U.S. at 586 n.5 (Stevens, J., dissenting).

If Worthen makes a commitment not to exercise the option, at that point, circumstances may change significantly to recognize Lyon as the owner. Until such an event occurs, Justice Stevens would treat Worthen as the owner of the entire facility, since Worthen has an unrestricted cost-free power to exercise an option to purchase for the primary 25-year term.

\textsuperscript{53} \textit{Id.} at 587 n.7 (Stevens, J., dissenting).

\textsuperscript{54} \textit{See} note 39 \textit{supra}.

\textsuperscript{55} Justice Stevens stated, [Lyon] assumed the risk that Worthen might \textit{not} exercise its option to purchase at or before the end of the original 25-year term. If Worthen should
Lyon a depreciable interest in the facility. To bar depreciation deductions because of these options would impose an injustice on Lyon who otherwise would have had a depreciable interest in the facility.

Justice White also filed a dissent and agreed with the analysis of the Court of Appeals for the Eighth Circuit which had examined the issue of ownership through the actual allocation of interests made by the parties. Since Lyon would be guaranteed a return on his investment with interest throughout the maximum period of the transaction, Lyon incurred insignificant benefits, risks, and burdens to substantiate its claim as owner of the building for tax purposes. This analysis differs from that of Justice Stevens who conceded that Lyon could become the owner upon Worthen’s sacrifice, during the course of the lease, of its cost-free power to exercise its options. In the view of Justice White and the Court of Appeals for the Eighth Circuit, however, Lyon could become the owner only after the facility reverted back to Lyon upon termination of the lease.

Both dissenting Justices based their conclusions on the effects of the option terms and both assumed that Worthen at some time would exercise one of the options. The opinions ignored the key fact that “simply too many contingencies, including variations in value of real estate, in the cost of money, and in the capital structure of Worthen,” existed to automatically assume that Worthen would not “walk away” from the relationship at the end of the pri-

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exercise that right not to repay, perhaps it would then be appropriate to characterize petitioner as the owner and Worthen as the lessee.

435 U.S. at 587 (Stevens, J., dissenting). By this statement, Stevens rests his conclusion of no depreciable interest in Lyon on the nature of the repurchase options. Without these options, Lyon will possess the proper interest for tax purposes.

56. See notes 98-101 infra and accompanying text.
57. Justice White filed a dissent, but did not write an opinion.
58. The Eighth Circuit analogized the interests held by the parties to a “bundle of sticks,” in which each stick represented an interest in the underlying property. For sufficient ownership interest for tax purposes, the taxpayer must have possessed sufficient genuine interests in its bundle. The Eighth Circuit, however, after examining the various interests allocated by the documents, concluded that Worthen clearly possessed every meaningful interest, and that in reality, Lyon “toted an empty bundle.” See Frank Lyon Co. v. United States, 536 F.2d 746, 751 (8th Cir. 1976).
59. But see note 39 supra.
60. 435 U.S. at 587 (Stevens, J., dissenting). See also note 52 supra.
61. Worthen was not economically compelled to renew or repurchase. See notes 94-96 infra.
62. 435 U.S. at 579.
mary rental period. The result, according to the majority, was that Lyon obligated its capital toward the building, and therefore could claim depreciation for the consumption of that capital.

Because of the complicated nature and the unique circumstances of the transaction in Lyon, the effects of the Lyon decision on future sale-leaseback arrangements is speculative. Since Lyon is the first three-party sale-leaseback on which the Supreme Court has ruled, tax planner and tax collector alike will seek to use the decision to their advantage. Thus, framers of three-party sale-leasebacks must consider Lyon within the scope of existing law and policies concerning these transactions. Failure to consider the impact of Lyon could completely frustrate the overall business objectives of the transaction, leaving the investor-lessee without the tax benefits required for a profitable transaction.

IV. CLASSIFICATION OF THE WORTHEN-LYON TRANSACTION

The Worthen-Lyon transaction was a specialized form of sale-leaseback known as a finance lease. Under a finance lease, the lessor provides an initial investment from out-of-pocket funds and then finances the balance through a recourse mortgage loan. The third party mortgagee’s interest in the transaction centers on its recovery of the mortgage without interrupting the lease agreement between the lessor and lessee. Since the lessor assigns its interest in the lease to the mortgagee, the mortgagee is chiefly concerned with the financial stability of the lessee. As long as the lease re-

63. Lyon’s capital consisted of $500,000 out-of-pocket funds and borrowed funds from the New York Life mortgage.


The investor-lessee participates in the venture with a proportionally small out-of-pocket investment in the purchase. The rental payments which are usually assigned to the mortgage guarantee enough income to the lessor for repayment of the mortgage with interest. Also, the mortgagee’s risk is reduced, not only by the assignment of the lease, but by the recourse liability of the lessor if the lessee should walk from the transaction.

65. In most financing leases, the rent covers the cost of the property, amortized over a period of time equal to the amounts due on the mortgage. The lessor, at the outset of the transaction, assigns its interest in the rents to the mortgagee, thus guaranteeing the mortgagee that the rents will flow directly to it to amortize the mortgage.

66. New York Life in the transaction constitutes such a third party. In accepting the 25-year mortgage, New York Life expected its payment through the rents from the Worthen-Lyon lease, since Lyon had assigned all interests in the lease to it.
mains in effect, the lease assignment by the lessor will guarantee repayment of the mortgagee's full expected return. If the lessee should "walk" from the transaction, the lessor loses the guaranteed source of funds intended by the parties to satisfy the mortgage. The mortgagee, if the lessor cannot secure another lessee and lacks the sufficient funds to satisfy the mortgage, may realize less than the full expected return. Because of the recourse nature of the transaction, however, the full burden of repayment ultimately falls on the investor-lesser. No matter how the transaction concludes, the lessor must satisfy the mortgage or be subject to foreclosure.

Unlike the more simple two-party sale-leaseback, which developed solely as a tax sheltering device, the finance lease evolved as a financing technique to raise the capital necessary for long-range equipment and facility purchases. Yet, from the investor-lesser's point of view, the primary appeal of the finance lease is the various tax advantages it offers. These tax considera-

67. What the mortgagee recovers depends on the terms of the mortgage agreement. Because the mortgage is recourse, the lessor will be personally liable on the mortgage. The lessor, however, may feel that default would be more practical than being "stuck" with the building throughout the mortgage period. Besides being without a tenant and a source of revenue, the lessor will incur the expenses associated with ownership of such a building including maintenance, insurance, and taxes, as well as the debt service on the mortgage. The lessor thus will default, resulting in an acceleration of the mortgage with penalties. The terms will guarantee to the mortgagee immediate recovery of the principal, but the penalty will not equal the return rate if the transaction had continued for the full period. The mortgagee will have the facility sold at a foreclosure sale with the lessor liable through a deficiency judgment for any amount remaining on the mortgage not realized from the sale.

68. The Supreme Court considered Lyon's assumption of the risk in the investment as a key factor in deciding in Lyon's favor. See 435 U.S. at 567-77. See also notes 102-06 infra and accompanying text.

69. See generally Cary, supra note 3; Zeitlan, supra note 1.

70. Lefevre, supra note 64, at 764-65. A new financing industry has evolved in leasing for major industries in need of new sources of capital over the last several years; a phenomenon Lefevre attributes to sluggish new-issue securities markets and increased interest rates. Citing the transportation and utility industries as examples, Lefevre states that "scarcely a major capital project is undertaken without consideration of lease financing." Id. at 764.

71. See Young, supra note 3, at 290-94. See also Comment, Sale and Leaseback Transactions, 52 N.Y.U.L. Rev. 672 (1977). The tax advantages of the transaction allow the buyer-lessee depreciation deductions under I.R.C. § 167, and in some situations investment credit under I.R.C. § 38, which can be transferred to the lessee under I.R.C. § 48. The seller-lessee receives rent deductions under I.R.C. § 162. Business advantages for the buyer-lessee consist of a safe investment of its capital. The seller-lessee has the advantages of raising capital for the full market value of the property, still has use of the facility, and prevents any liability from being entered on its books so as not to hinder future borrowing.
tions, in the form of investment credit, accelerated depreciation, and interest deductions, determine the investor’s financing profit, and create a leasing rate lower than the cost of borrowed funds. The disallowance of the tax benefits increases the cost of leasing to the lessee and reduces the lessor’s return on its investment. This destroys the original business objectives of the transaction. Thus, while the transaction is primarily a financing technique for the lessee, its structure requires significant tax benefits for the investor-lessee. Guidelines for the tax treatment of these arrangements are needed to uphold the business purpose of the transaction desired by the parties, while maintaining a form acceptable to the Service.

72. The investor seeks to recover from the transaction an amount greater than the interest paid on the mortgage. This amount may be generated from the rents. Where the lessor agrees to a zero cash flow—rental payments equal to the amortized amount of the loan resulting in zero profits from that source of cash remaining with the lessor—the tax benefits remain the only reliable source of gain to the investor-lessee.

73. These tax consequences effectively grant the lessor, as the investor, sufficient tax benefits that produce a lease rate lower than the costs of borrowed funds. In the Worthen-Lyon transaction, the borrowed funds of $7,140,000 amortized at 6.5% over 25 years would equal $14,989,767.24, resulting in a financing cost to Lyon of $7,849,767.24. The rents equaled the exact amount necessary to fully amortize the New York Life note. Since Lyon’s profit on the investment was not figured into the rent, he possessed a zero cash flow. Yet, under I.R.C. § 61, the rental payments would be included in Lyon’s gross income each year.

The various tax benefits, however, offset the rental payments included in Lyon’s gross income. Under I.R.C. § 163(a), the interest cost would be deducted, leaving $7,140,000 of rents which represented the principal of the loan to be offset by further deductions. The investment credit allowed under I.R.C. § 38 would offset some of that balance. In this case, however, the credit was retained by Worthen under I.R.C. § 48(d), leaving only the depreciation deductions to offset the balance of the rents.

Under Crane v. Commissioner, 331 U.S. 1 (1937), the portion of the property financed by borrowed funds is depreciable even though the owner has a small percentage of out-of-pocket funds invested in the project. Thus, as in Lyon, where the facility’s lifetime equals that of the loan period, the entire cost of the facility can be deducted as depreciation during the repayment of the loan.

Under I.R.C. § 167, the depreciation may be accelerated, resulting in a depreciation of the facility in Lyon during the first 11 years of the 25-year life of the facility. Assuming that Lyon has sufficient income to be offset by the deductions beyond the rentals received from Worthen, the after-tax benefit could total 1.5 million dollars. See 435 U.S. at 572 n.10. If Worthen exercises the 11th-year repurchase option, Lyon would receive the remaining balance plus his investment with interest, subject to capital gains taxes on the sale. Also, even if Worthen leases for the full term of the lease, Lyon will have benefited from the deferment of the tax liability which is in essence a loan from the government. See also Gallagher, supra note 23; Lefevre, supra note 64, at 772-73; Schmidt & Larsen, Leveraged Lease Arrangements: Tax Factors that Contribute to their Attractiveness, 41 J. TAX. 210 (1974).

74. This is especially true in the Worthen-Lyon situation where Lyon opted for a zero cash flow in expectation of the various tax benefits associated with the transaction.
V. The Search for Guidelines

The Supreme Court's multi-faceted analysis failed to provide sufficient guidelines necessary for competent tax and business planning. Instead, the Court offered a general holding that whether "a genuine multiparty transaction with economic substance" exists in a particular situation will depend on the facts of the case. The development of leasing as a financing technique requires guidelines sufficient to guarantee that the lessor possesses a depreciable interest in the property at the time the parties formulate the transaction. Otherwise, the transaction fails to accomplish its ultimate goal of reduced financing costs to the lessee and maximum investment return to the lessor. Since the opinion offers little in terms of adequate guidelines, the pre-Lyon law and the effects of the decision on it must be evaluated.

The present Internal Revenue Service guidelines do not provide a concrete basis upon which to formulate future real estate financing leases. In its first major ruling on leasing, Revenue Ruling 55-540, the Service listed a number of factors which it considered evidence of a sale rather than a lease. These factors, however, dealt with equipment leases and except in the most clear-cut situations were too general to be of use to tax planners.

The period after these early rulings marked the debut of a variation of the finance lease known as the leveraged lease. The leveraged lease typically involves the following: (1) A lessor who creates leverage by committing his personal funds to the purchase price (usually 20%), borrows the remainder on a non-recourse basis, and then leases the property to another party on a net lease basis for substantially the property's useful life; (2) a lender who finances most of the purchase price on a non-recourse basis relying solely on the leased property and the lease as security; and (3) a lessee who obligates itself to rental payments sufficient to allow the lessor to recover its investment and to service the debt, usually with a profit. See Mann & Schmidt, The New Leveraged Lease Guidelines, 6 Tax Advisor 390 (1975).
lessor retains part of the cost of the property by a non-recourse loan secured solely by a mortgage on the property and a security assignment of the lease.\textsuperscript{80} In response to this development, the Service issued Revenue Procedure 75-21,\textsuperscript{81} which announced specific guidelines\textsuperscript{82} for the circumstances under which it would issue a ruling on a leveraged lease. In Lyon, however, the Court properly observed in a footnote\textsuperscript{83} that the Service's guidelines were not definitive and that they offered little guidance in formulating real estate lease transactions.

Since the criteria employed by the Service to evaluate real estate leases remains speculative, the ultimate source of guidelines continues to be the various lease characterization cases resolved over the last three decades.\textsuperscript{84} The courts, in ascertaining the economic substance of these transactions, have traditionally dealt first with an examination of the business bargain formulated by the parties. The earlier lower court decisions focused on the legal effect of the transaction intended by the parties; their allocation of interests, as read in the light of the relevant facts and circumstances existing at the time of the transaction.\textsuperscript{85}

The United States Supreme Court in Lyon concluded that the

80. Javaras & Nelson, supra note 77; Lefevre, supra note 64, at 773-76.
81. 1975-1 C.B. 715. This ruling has no effect on Lyon, since it was issued after the transaction.
82. The guidelines in general include the following: (a) The lessor incurs and maintains a minimal investment equaling 20% of the cost of the property; (b) the lessee can purchase only at fair market value; (c) the lessee furnishes no part of the cost of the property; (d) the lessee has not lent to the lessor or guaranteed any part of his indebtedness; and (e) the lessor must expect a profit on the transaction other than from the tax treatment benefits. See also 435 U.S. at 577 n.14.
83. Id. See also Rosenberg & Weinstein, supra note 11, at 147 n.1. The distinction between real property and equipment leasing is that equipment will almost inevitably diminish in value through wear and tear, resulting in little or no residual value at the end of the lease. Realty, however, because of customary maintenance and improvements, frequently maintains its value and often may increase in value over the period of the lease.

After considering to some extent the complaints of the real estate industry, the Service agreed not to consider the general application of Rev. Proc. 75-21 to real property. See id. (citing a letter from John W. Holt, Director, Corporate Tax Division, to the National Retail Merchants Association, May 28, 1975).
84. See Lefevre, supra note 64, at 772-73.
85. See generally Starr's Estate v. Commissioner, 274 F.2d 294 (9th Cir. 1959); Oesterreich v. Commissioner, 226 F.2d 798 (9th Cir. 1955); Benton v. Commissioner, 197 F.2d 745 (5th Cir. 1952). These early cases concentrated on the lease versus sale issue and, in most cases, involved only two parties. The intent issue, however, has been carried over into the three-party cases. See Sun Oil Co. v. Commissioner, 562 F.2d 258 (3d Cir. 1977).
parties intended an allocation of interests associated with a sale-leaseback. The Court, however, failed to analyze the legal significance of the intent of the parties in arriving at the interest allocations. In cases where unambiguous and complete documents clearly define the allocation of interests, the lower courts have focused their analysis on the substance of the transaction in light of its background at the time of the execution of the agreement. In this traditional approach, the parties' good-faith belief as to the legal effects of the documents is irrelevant in ascertaining economic substance. Where, however, the basic rights, duties, and economic interests of the parties are disputed, and the documents are incomplete and ambiguous, the courts view the parties' subjective intent as an indication of the true allocation of interests among the parties. The result of traditional judicial analysis is that the objective interest allocation as expressed by the written documents establishes the legal effect of the transaction, while the subjective intent of the parties merely establishes the gist of otherwise vague or incomplete agreements.

In Lyon the parties' subjective intent was irrelevant because the documents clearly spelled out the terms of the transaction. Tax planners, to assure that the desired interest allocation is preserved, must draft documents which indisputably characterize the allocation of interests intended by the parties. Otherwise, if the allocation is vague, a court will employ the unexpressed subjective intent of the parties as ascertained by the existing facts and circumstances to reveal the substance of the transaction. Reliance on

86. 435 U.S. at 579.
87. Sun Oil Co. v. Commissioner, 212 F.2d 258 (3d Cir. 1977). See also M & W Gear Co. v. Commissioner, 446 F.2d 841 (7th Cir. 1971); Western Contracting Co. v. Commissioner, 271 F.2d 694 (8th Cir. 1959); Haggard v. Commissioner, 241 F.2d 288 (9th Cir. 1956); Breece Veneer & Panel Co. v. Commissioner, 232 F.2d 319 (7th Cir. 1956); Benton v. Commissioner, 197 F.2d 745 (5th Cir. 1952); Universal Drilling Co. v. United States, 412 F. Supp. 1231 (E.D. La. 1976); Arkansas Bank and Trust Co. v. United States, 224 F. Supp. 171 (W.D. Ark. 1963); Frito-Lay, Inc. v. United States, 209 F. Supp. 886 (N.D. Ga. 1962).
88. Sun Oil Co. v. Commissioner, 562 F.2d 258, 262 (3d Cir. 1977). The result is that the subjective intent of the parties becomes a consideration for the court only in the interpretation of the agreement. Once the rights, duties, and economic interests are determined, subjective intent becomes totally immaterial in the characterization of the transaction for tax purposes.
89. The Eighth Circuit dealt with the issue at length. It concluded that the documents represented the true allocation of interests between the parties, so as to render any inquiry into the parties' subjective intent irrelevant. See Frank Lyon Co. v. United States, 536 F.2d 746, 750-51 (8th Cir. 1976).
the intent factor, which itself is a question of fact, is a risky and unpredictable approach which the prudent tax planner should avoid.

Rather than looking to subjective intent, the Lyon Court concentrated on the primary task of determining the economic substance of the transaction from the parties' objective intent as expressed in written documents. In this area, lower courts have emphasized the acquisition of an "equity" in the property by the lessee as a fundamental factor in determining the economic substance of a sale-leaseback. If the lessee acquires an equity during the course of rental payments, it is deemed the owner of the property for tax purposes. The parties' "objective intent" to acquire ownership of the property determines the existence of the equity. If the lessee acquires an option to purchase at substantially below fair market value at the date of exercise, if he is economically compelled to renew the lease or to purchase, or if he receives a

90. Sun Oil Co. v. Commissioner, 562 F.2d 258 (3d Cir. 1977).

91. The economic factors which surround the transaction permit the allocation of interests between the parties, allowing the substance of the transaction to be pinpointed. The importance of this stage of analysis rests in the fact that if the cumulative effect of these factors deprives the lessor of significant ownership, the lessee will be treated as the owner of the facility for tax purposes.

92. See Lefèvre, supra note 64; Rosenberg & Weinstein, supra note 11, at 150. Equity is defined as the lessee acquiring ownership of his leasehold through the application of rental payments toward a future purchase price.

93. See generally M & W Gear Co. v. United States, 446 F.2d 841 (7th Cir. 1971); Western Contracting Corp. v. Commissioner, 271 F.2d 694 (8th Cir. 1959); Oesterreich v. Commissioner, 226 F.2d 796 (9th Cir. 1955); Benton v. Commissioner, 197 F.2d 745 (5th Cir. 1952); Universal Drilling Co. v. United States, 412 F. Supp. 1231 (E.D. La. 1976); Arkansas Bank and Trust Co. v. United States, 224 F. Supp. 171 (W.D. Ark. 1963); Frito-Lay, Inc. v. United States, 209 F. Supp. 886 (N.D. Ga. 1962).

94. Oesterreich v. Commissioner, 226 F.2d 796 (9th Cir. 1955) (real estate lease with option to reacquire title at the end of a 68-year term for $10 not a lease for tax purposes); LVT Corp. v. Commissioner, 63 T.C. 39 (1974) (option to purchase based on expected fair market value of the property at exercise date ruled as a valid lease); Northwest Acceptance Corp. v. Commissioner, 58 T.C. 836 (1972), aff'd, 500 F.2d 1222 (9th Cir. 1974) (substantial options to purchase on equipment lease held valid).

It should be noted that not every lease that contains an option to purchase is automatically disregarded for tax purposes. One who takes an option may do so with the hope of exercising it, but not necessarily with the intent of creating an equity interest during the lease term. See Breece Veneer & Panel Co. v. Commissioner, 232 F.2d 319 (7th Cir. 1956). The decision ultimately depends on the objective intent of the parties, indicated by the economic factors of the case in the light of the facts and circumstances existing at the time of the formation of the agreement. See Benton v. Commissioner, 197 F.2d 745 (5th Cir. 1952); Frito-Lay, Inc. v. Commissioner, 209 F. Supp. 886 (N.D. Ga. 1962).

95. Usually, the situation arises where the rents are high during the primary
bargain renewal option, the lessee acquires for tax purposes an equity interest in the property through his rental payments.

In Lyon, no such equity existed since there was no legal obligation between the parties representing an agreed return on the investment. In the finance lease situation, equity exists if the rents indicate a fixed return on the owner's investment or if the options when exercised are intended to provide that fixed return, regardless of the appreciation or depreciation of the property. Lyon would realize such a return if Worthen exercised one of the repurchase or renewal options, but the Court concluded that this exercise could not be guaranteed with reasonable certainty. Worthen could walk away from the transaction after the primary lease expired, since it was not legally or economically compelled to stay.

The lack of a guaranteed investment return for Lyon imposed sufficient risks and benefits of ownership on Lyon. It is this ownership interest which determined that the transaction possessed sufficient economic substance for taxation purposes. The result, as the Court concluded, was a sufficient depreciable interest attributed to Lyon. Therefore, for a finance lease to be economically substantial, the repurchase and renewal options must allow the lessor to participate in the risks and benefits normally associated with a depreciable interest.

term, or where the lessee has made improvements in the property, and the purchase or renewal options are so low that the lessee becomes economically compelled to exercise. Lefevre, supra note 64, at 767-70.


97. The government had contended that the $500,000 investment by Lyon constituted a loan at a guaranteed return of 6%. As later indicated by the Court, the rents alone failed to provide this return, since the only way the return could be realized was by the renewal or repurchase options being exercised by Worthen. See 435 U.S. at 579.

98. In the earlier, simpler, two-party sale-leasebacks, the equity issue served to expose the transaction as a sale. If the lessee as a result of the rental payments acquires something of value in relation to the overall transaction beyond the mere use of property, then he acquires equity. See notes 93-96 supra and accompanying text.

99. See Sun Oil Co. v. Commissioner, 562 F.2d 258 (3d Cir. 1977) (rents and option privileges found to provide an equity by guaranteeing the investor a return on funds invested).

100. See notes 10 & 12 supra and accompanying text.

101. 435 U.S. at 583.
VI. THE EFFECTS OF LYON

The Supreme Court in Lyon offered tax planners insufficient guidelines to aid them in the planning of future finance leases. Instead of attempting to synthesize the vast array of case law and commentary, the opinion fuels the already raging dispute between taxpayer and tax collector. The Court upheld the finance lease as having the substance of a true sale-leaseback. It failed, however, to provide taxpayers with the essential guidelines for the formulation of individual finance leases.

The opinion does communicate pitfalls which must be avoided in future transactions. The Court believes that ownership for tax purposes requires a risk of loss and a possibility of a profit from an investment in property. These ownership risks are not based on calculated lease rates, since leases with zero cash return are considered valid and acceptable for tax purposes. The tax planner may continue to employ the tax benefits to calculate investment incentive and to compute the projected rate of return. If, however, the investment recovery is reasonably assured through the reduction of risk by a guaranteed residual or fixed options, then the transaction possesses insufficient economic substance for tax purposes. The transaction offers to the lessor no depreciable interest in the property, resulting in a recharacterization of the transaction as a loan. But, if the transaction passes muster by actually placing real and appropriate risks and benefits of ownership on the lessor, then the government is bound to follow the form adopted by the parties.

The Lyon decision may have a significant impact on leveraged lease transactions. In an earlier case before the Tax Court,  

102. See notes 97-101 supra and accompanying text.
103. See Lefevre, supra note 64, at 774. The lease rates are calculated to be somewhat less than the interest rates on borrowed funds. The investors hope to profit from the residual and the tax benefits even to the point of accepting a lease which produces only enough rent to service the debt, i.e., zero cash return.
104. Rosenburg & Weinstein, supra note 11. The absence of a cash flow should not be significant, since it merely serves a function of the extent to which the owner has borrowed to purchase the property. The critical ownership attribute is the rent for the use of the property. If the lessee pays a fair rental value, then the fact that all the rental is used by the lessor to service a debt should not effect ownership.
105. See notes 71-73 supra and accompanying text.
106. See notes 97-101 supra and accompanying text.
107. Even though the Worthen-Lyon transaction was not a leveraged lease transaction, the two are nevertheless akin to each other. The leveraged lease, however, attempts to remove personal liability from the lessor for the financing if the transaction should fall through during the lease period. See notes 64-68 supra and accompanying text.
David F. Bolger, the court created a unique tax shelter by treating a lessor of property acquired with no cash investment but with large non-recourse financing as the owner of the property. This enabled the taxpayer to offset excess earnings beyond rental payments through large accelerated depreciation deductions with very little personal investment. Under this ruling, the taxpayer achieves tax postponement through the depreciation deductions and can still walk away from the building and the loans if the transaction should collapse. The Tax Court, despite the lack of risk in the investment, concluded that for tax purposes the amount of the investment financed by the non-recourse mortgage constituted a depreciable interest.

The Supreme Court in Lyon emphasized that Lyon's personal liability on the mortgage notes was an important factor surrounding the Worthen-Lyon transaction. The Court did not directly condemn transactions in which the lessor's liability was substantially non-recourse. But, by emphasizing Lyon's personal liability on the mortgage note, the Court implied that in chameleon-like transactions where the investment is a non-recourse liability, that investment, when considered in the light of other factors surrounding the individual transaction, will indicate a debtor-creditor relationship between the parties. Since non-recourse financing shifts the transaction toward a debtor-creditor relationship, other factors must exist in the transaction to balance the lack of personal risk in the financing. The crucial factor for the tax planner to consider would be the avoidance of renewal and repurchase options which include a guaranteed return. Even though the options would meet the mandates of Lyon through uncertainty in the lessee's exercise and the lack of economic compulsion on the lessee to exercise the options, such a factor might be outweighed by the total lack of personal risk in the financing by the investor-lessee. Since the combination of these factors would undoubtedly produce a debtor-creditor relationship, the parties must choose between non-recourse financing and options which guarantee a return though uncertain in their exercise. If the parties choose non-recourse

109. The Bolger procedure is explained in Comment, Tax Court Approves Two Real Estate Tax Shelter Deals; Cases may be Appealed, 38 J. TAX. 263 (1973). For an analysis of the effects of Bolger, see Lurie, Bolger's Building: The Tax Shelter That Wore No Clothes, 28 TAX L. REV. 355 (1973).
110. 435 U.S. at 577.
111. For a list of factors, see id. at 582-83.
112. See notes 93-101 supra and accompanying text.
financing and base the options on fair market value without consideration of a guaranteed return in any form, any argument by the Service based on Lyon that attacks the non-recourse financing would be weakened by the lack of a guaranteed return. If both non-recourse financing and guaranteed return are chosen, the Service can then forcefully argue that the non-recourse liability of the lessor distinguishes that case from Lyon and therefore the transaction possesses insufficient substance to constitute a depreciable interest.

Planning sale-leasebacks seeks to assure that the transaction results at its inception in an economically genuine lessor-lessee relationship that will permit the tax benefits to flow to the lessor-investor. Sufficient risks and benefits of ownership must remain with the lessor during the entire course of the lease period. Otherwise, the tax benefits will not accrue to the lessor, resulting in the disruption of the business purposes for which he entered into the transaction.113

Many of the motivating factors surrounding the Lyon transaction may not exist in other finance leases. Among these are the legal restraints preventing Worthen from building its own facility, Worthen’s possession of options by order of the banking regulators, and the requirement by the federal banking regulators of ownership of the building by an independent third party.114 Yet, circumstances in Lyon do exist which render the decision a useful tax planning tool, despite the lack of specific guidelines within the decision. The personal liability of the lessor,115 the lessee’s repurchase and renewal options which neither gave the lessee an increasing equity116 nor guaranteed the lessor a recoupment of its investment,117 and the independence of the investor-lessee from the lessor, all indicated a transaction with substantial economic substance. Such factors exist in most of today’s finance leases. Failure to examine them in light of Lyon will result in the classification of the transaction as a financing technique with little or no attributes of a lease, and ultimately in the disallowance of the anticipated deductions to the lessor.

Jerome J. Kavulich

113. See notes 64-74 supra and accompanying text.
114. See 435 U.S. at 582.
115. See id. at 577.
116. See notes 94-96 supra and accompanying text.
117. See notes 92-101 supra and accompanying text.