

MARKS & WEINBERG, P.C.

Harry E. Peadar, Jr. v. I.R.S.

113 T.C. 116 (2000)

Country Fed, a Georgia Small Business Corporation, in the business of selling meat, chicken and seafood products through direct sale, entered into separate agreements (collectively, the "Master Leases") with World Omni Leasing, Inc. ("World Omni"), McCullah Leasing, Inc. ("McCullah"), and Automatic Rentals, Inc. ("ARI") (collectively, the "Lessors") covering trucks and refrigeration units.

As a part of each lease transaction, Country Fed executed the TRAC lease certification required by §7701(h)(2)(c) of the Internal Revenue Code. In each lease transaction, the Lessor's rental income over the period of the lease exceeded the Lessor's depreciation and cost of financing its purchase of the trucks. Each truck's useful life extended beyond its respective lease term. The Master Leases were negotiated in arms length transactions and each contained among other provisions: (1) the term of the lease, (2) the base rent, and (3) the monthly rental charge.

The base rent represented the sum of all of the monthly rent due throughout the lease transaction for the particular truck. The base rent was dependent on Lessor's cost of obtaining the truck and refurbishing it to petitioner's specifications, including the purchase and installation of refrigeration units. Over the term of the Lease, a fixed monthly portion was applied to reduce the base rent such that at the end of the lease term, the base rent was zero. The remaining portion of the rent was a service and administrative charge that was not applied to reduce the base rent.



In addition to the monthly rent, Country Fed was required to pay all registration and compliance fees not included in the base rent. Also under the Lease, Country Fed was responsible for any damage to the trucks and was required to pay the Lessor the remaining base rent if a truck was damaged beyond repair. The title remained with the Lessor and at the end of the lease term for a particular truck, Country Fed was responsible for returning the truck to the Lessor and was required to continue paying the Lessor the monthly service and administrative fees. Upon return of the truck to the Lessor, the Lessor was obligated to sell the truck and any proceeds of the sale obtained by the Lessor that exceeded any remaining base rent, plus the cost to the Lessor of arranging the sale, was remitted to Country Fed. If the proceeds of the sale were less than any remaining base rent, plus the cost to the Lessor of arranging the sale, Country Fed was required to pay the Lessor the difference (such amount hereafter referred to as the terminal rental adjustment clause or "TRAC").

The issue for the court was whether §7701(h)(1) voids the TRAC provisions of the lease and whether the lease transactions should be treated as leases or as purchases. Obviously, if the transactions are treated as purchases, then certain substantial tax deductions taken by Country Fed would be disallowed and Country Fed would be required to repay those deductions to the I.R.S.

The court determined that the plain language of §7701(h)(1) required the court to look at the transactions without the TRAC and further determined that the leases were true leases. The I.R.S. argued substance over form and because Country Fed stated that it rented the trucks because no down payment was required. The court found in favor of Country Fed

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