IN THE UNITED STATES COURT OF APPEALS

FOR THE FIFTH CIRCUIT

No. 92-4804

Summary Calendar

WILLIAM LOHMAN BALIS,
MARGARET BUELL BALIS,

Petitioners,

versus

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

Appeals from the United States Tax Court
(27250-87 c.w 8080-88 & 32376-88)

(February 22, 1993)

Before KING, DAVIS and WIENER, Circuit Judges.

PER CURIAM:*

William Lohman Balis and Margaret Buell Balis (together "taxpayers") appeal from the Tax Court's determination that transactions regarding a trust they created constitute sham transactions which are not recognizable for federal tax purposes. Finding no error, we affirm.

---

* Local Rule 47.5 provides: "The publication of opinions that have no precedential value and merely decide particular cases on the basis of well-settled principles of law imposes needless expense on the public and burdens on the legal profession." Pursuant to that rule, the court has determined that this opinion should not be published.

I

A

Taxpayers formed the Balis Family Preservation Trust ("the Balis Trust") in July 1982 through an instrument referred to as the Declaration of Trust ("the Declaration"). For guidance in establishing the trust, taxpayers relied upon a publication entitled A Manual on How to Establish a Trust and Reduce Taxation, which was written by Martin Larsen and published by an organization known as Liberty Lobby.[1]

The Declaration named Margaret and a neighbor, Pearlene C. Laprairie, as trustees--positions they both held throughout the years 1982 to 1985. The Declaration states, in pertinent part, that:

> The Board of Trustees shall have all the powers necessary, convenient or appropriate to effectuate the purpose of the trust, and shall take action which it deems necessary or desirable and proper to carry out such purposes, provided, however, those purposes and actions are not inconsistent with other provisions herein. Any determination of the purpose of the Trust, made by the Board of Trustees, in good faith, shall be conclusive.

The Declaration did not explicitly designate beneficiaries. Nevertheless, according to the testimony of William Balis, during

[1] In United States v. Smith, 814 F.2d 1086 (5th Cir. 1987), this court affirmed, without opinion, a federal district court's determination that sales of this publication were subject to a penalty pursuant to 26 U.S.C. § 6700 for promotion of an abusive tax shelter. See United States v. Smith, 657 F. Supp. 646 (W.D. La. 1986), aff'd, 814 F.2d 1086 (5th Cir. 1987). We also affirmed the court's decision to enjoin further sales of the publication under 26 U.S.C. § 7408. See id.

the years at issue, Margaret Balis held a 50% beneficial interest in the trust and the Balis' two sons each held a 25% interest.

Taxpayers transferred substantially all of their real and personal property to the trust through two conveyances. First, Margaret transferred all her personal property and her interests in real and personal property held jointly by taxpayers to William. Second, William transferred this same property to the Balis Trust. The properties transferred included a coin-operated laundromat, a coin-operated car wash, a pecan orchard, and taxpayers' personal residence.

In August 1982, the Balis Trust leased back to taxpayers some of the property they had transferred to the trust: taxpayers' residence was leased to them for $300 per month, the laundromat and car wash were leased to them for $900 per month, and the orchard was leased to them for $250 per month. Moreover, the trust entered into individual service contracts with Margaret and William. Under the terms of these contracts, Margaret carried out clerical and administrative functions on behalf of the trust for a fee not to exceed $150 per month, and William performed caretaking responsibilities in exchange for payments of monthly fees. In sum, during the years at issue, taxpayers continued to reside in the home they conveyed to the Balis Trust, paying rent to the trust for its use and collecting fees for maintaining it as they had prior to its conveyance. Moreover, there was no recognizable difference in the way they operated their businesses, except that they paid rent to the Balis Trust and charged the trust for their services.

During each of the taxable years 1982 through 1985, taxpayers jointly filed Form 1040 Income Tax Returns. On each of these returns, they adjusted their income amounts by deducting the rental sums paid to the Balis Trust and including the sums paid to them under the service contracts. Taxpayers also filed Form 1041 Income Tax Returns on behalf of the Balis Trust, in which they (1) reported the monies they paid to the trust in rent and dividends on the accounts they conveyed to the trust as income, and (2) claimed depreciation for the residence and business properties they had conveyed to the trust.

B

The Commissioner of Internal Revenue determined that the creation of the Balis Trust and taxpayers' subsequent conveyances of property constitute sham transactions not recognizable for federal tax purposes. Accordingly, the Commissioner disallowed deductions claimed by taxpayers for their rental payments to the trust and determined that all income received by the Balis Trust from third parties was attributable to taxpayers. Moreover, the Commissioner (1) determined that taxpayers were subject to self-employment taxes pursuant to 26 U.S.C. § 1401, (2) calculated deficiencies in taxpayers' federal income taxes for the taxable years 1982, 1983, 1984, and 1985 in the amounts of $900.00, $1582.00, $2514.08, and $2037.86, respectively, and (3) asserted tax additions pursuant to 26 U.S.C. §§ 6653(a)(1) & (a)(2) (titled "Additions to tax for negligence and fraud").[2]

Taxpayers filed petitions with the United States Tax Court, which held in favor of the Commissioner. The Court consolidated these petitions and found that taxpayers retained both beneficial enjoyment and the power of disposition over the properties included in the Balis Trust, and that, under the "grantor-trust" provisions of the Internal Revenue Code, 26 U.S.C. §§ 671-77 ("the Code"), the Balis Trust is not recognizable for tax purposes. Specifically, the Court found that the Balis Trust is a sham "done merely to support [taxpayers'] claims of deductions for depreciation on [their] residence and rent for [their] use of the business property . . . ." Taxpayers appeal from the Tax Court's decision.

II

Although taxpayers have put forth a series of specific contentions to challenge the Tax Court's determinations, these contentions raise a single issue: whether the Tax Court correctly determined that the Balis Trust should not be recognized for federal tax purposes, thereby disallowing deductions under the trust claimed by taxpayers and taxing

[2] In 1989 amendments to the Code, this provision was substituted by provisions for failure to pay the stamp tax.

taxpayers on the income from assets transferred to the trust.[3] We find that it did.

A

Because they have provided the Balis Trust with all of its corpus, taxpayers are the sole grantors of that trust. Under the Code, if a grantor (1) retains powers described in sections 674 through 677 and (2) can exercise that power without the approval

---

[3] Many of these specific contentions are premised on assertions that the underlying transactions are recognized under Louisiana state law and, to the extent that the Commissioner has refused to recognize them for federal tax purposes, the Commissioner's actions constitute an unconstitutional application of the Internal Revenue Code. We reject this line of argument, for it is firmly established that transactions lacking economic substance will be disregarded for federal income tax purposes, even if those same transactions are valid under state law. See Furman v. Commissioner, 45 T.C. 360, 364 (1966) ("A finding of validity under State Law . . . does not mean that the trust will necessarily be recognized for tax purposes."), aff'd, 381 F.2d 22 (5th Cir. 1967); Schulz v. Commissioner, 686 F.2d 490, 493 n.10 (7th Cir. 1982) (stating that taxpayers' arguments about the validity of their family trust under state law, "which comprise large sections of their consolidated brief, are irrelevant.").

Moreover, taxpayers have alleged no facts to substantiate their claims that the Commissioner's actions constitute an unconstitutional application of the Tax Code. Specifically, taxpayers assert that the Tax Court has created an arbitrary distinction between "family trusts" and other types of trusts, and that the Tax Court's designation of their trust as a "sham" has denied them the due process and equal protection guaranteed under the United States Constitution. Similar contentions were rejected by the Supreme Court long ago. See, e.g., Carmichael v. Southern Coal Co., 301 U.S. 495, 509, 57 S. Ct. 868, 872 (1936) ("This Court has repeatedly held that inequalities which result from a singling out of one particular class for taxation or exemption, infringe no constitutional limitation."); see also Walters v. City of St. Louis, 347 U.S. 231, 237, 74 S. Ct. 505, 509 (1953) ("Equal protection does not require identity of treatment. It only requires that classification rest on real and not feigned differences, that the distinction have some relevance to the purpose for which the classification is made, and that the different treatments be not . . . wholly arbitrary.").

of an "adverse party" as described in section 672(a),[4] the grantor is to be treated as the owner of the trust property and the trust will be ignored for federal tax purposes.[5] See United States v. Buttorff, 761 F.2d 1056, 1061 (5th Cir. 1985); Schulz v. Commissioner, 686 F.2d 490, 495 (7th Cir. 1982) ("The main

---

[4] This section provides that:

> the term `adverse party' means any person having a substantial beneficial interest in the trust which would be adversely affected by the exercise or nonexercise of the power which he possesses respecting the trust. A person having a general power of appointment over the trust property shall be deemed to have a beneficial interest in the trust.

26 U.S.C. § 672(a) (emphasis added).

[5] Specifically, under section 674 of the Code,

> The grantor shall be treated as the owner of any portion of a trust in respect of which the beneficial enjoyment of the corpus or the income therefrom is subject to a power of disposition, exercisable by the grantor or a nonadverse party, or both, without approval or consent of any adverse party.

26 U.S.C. § 674(a) (emphasis added). Similarly, under section 677,

> The grantor shall be treated as the owner of any portion of a trust, whether or not he is treated as such owner under Section 674, whose income without the approval or consent of any adverse party is, or, in the discretion of the grantor or a nonadverse party, or both, may be--
>
> (1) distributed to the grantor or the grantor's spouse . . . .

26 U.S.C. § 677(a) (emphasis added). As for the tax implications of the grantor's status under the Code, section 671 provides that:

> [w]here it is specified in this subpart that the grantor . . . shall be treated as the owner of any portion of a trust, there shall then be included in computing the taxable income and credits of the grantor . . . those items of income, deductions, and credits against tax of the trust which are attributable to that portion of the trust to the extent that such items would be taken into account under this chapter in computing taxable income or credits against the tax of an individual.

26 U.S.C. § 671 (emphasis added).

thrust of the grantor trust provisions is that the trust will be ignored and the grantor treated as the appropriate taxpayer whenever the grantor has substantially unfettered powers of disposition."). In Buttorff, this court summarized the effect of these grantor-trust provisions:

> Basically, these sections provide that a trust will be ignored for tax purposes and the grantor will be treated as the appropriate taxpayer when he retains beneficial enjoyment of the corpus and income of the trust and the power to control and liquidate the trust either unilaterally or with the concurrence of someone who is not an "adverse party."

761 F.2d at 1061

In evaluating whether the Balis Trust is recognizable for federal tax purposes, we begin by addressing taxpayers' contention that, because Margaret relinquished all of her property to William prior to the establishment of the trust, Margaret should not be treated as a grantor under sections 671 through 677 of the Code. We conclude that Margaret is a co-grantor of the Balis Trust under the Code, for courts, including this court, have consistently held that the transfer of one spouse's interest in personal and real property to the other spouse, who, in turn, conveys such property to a trust is ineffective to avoid the grantor-trust provisions of the Code. See, e.g., Buttorff, 761 F.2d at 1061 (referring to this arrangement as one "consistently invalidated for tax purposes by the courts as grantor trusts"); Zmuda v. Commissioner, 731 F.2d 1417, 1421 (9th Cir. 1984); Holman v. United States, 728 F.2d 462, 464-65 (10th Cir. 1984); Schulz, 686 F.2d at 496.

As a co-grantor of the Balis Trust, Margaret cannot be consider an adverse party under section 672. See Buttorff, 761 F.2d at 1061; see also Neely v. United States, 775 F.2d 1092, 1095 (9th Cir. 1985); Holman, 728 F.2d at 464-65; Schulz, 686 F.2d at 496. The only potential adverse party in the Balis Trust arrangement was Laprairie, taxpayers' neighbor, who was named trustee. However, even if it is assumed that Margaret only had the power to exercise control over the trust's property with Laprairie's approval, Laprairie was not an adverse party under the Code for she did not have "a substantial beneficial interest in the trust which would be adversely affected by the exercise or nonexercise of the power which [s]he possesse[d] respecting the trust." 26 U.S.C. § 672; see also Stoecklin v. Commissioner, 865 F.2d 1221, 1226 (11th Cir. 1989) (trust deemed grantor-trust because non-grantor trustee did not exercise independent judgment over the trust). Laprairie's interest in the trust as a co-trustee is not enough, by itself, to transform her into an "adverse party" in satisfaction of section 672(a). See Treas. Reg. § 1.672(a)-1(a) ("A trustee is not an adverse party merely because of [her] interest as trustee.").

In sum, it was within the taxpayers' power to dispose of the Balis Trust corpus without the consent or approval of any "adverse party," and they had the opportunity to use and receive beneficial enjoyment from the trust's funds and property as they saw fit. Accordingly, we conclude that the Tax Court correctly deemed taxpayers owners of the Balis Trust in its entirety under sections 671 through 677 of the Code. _See_ _Hanson v. Commissioner_, 696 F.2d 1232, 1234 (9th Cir. 1983); _Schulz_, 686 F.2d at 494-96; _Vnuk v. Commissioner_, 621 F.2d 1318, 1321 (8th Cir. 1980); _Wesenberg v. Commissioner_, 69 T.C. 1005, 1013 (1978).

B

The Taxpayers also challenge the Tax Court's determination that their transactions involving the Balis Trust constitute sham transactions lacking economic substance. Because this finding constitutes a factual determination, we review it only for clear error. _See_ _Freytag v. Commissioner_, 904 F.2d 1011, 1015-16 (5th Cir. 1990) ("Whether a particular transaction is a sham is a question of fact reviewed under the clearly erroneous standard."), _aff'd on other grounds_, 111 S. Ct. 2631 (1991).

As stated by the Supreme Court in _Commissioner v. Court Holding Co._, 324 U.S. 331, 334, 65 S. Ct. 707, 708 (1945):

> The incidence of taxation depends upon the substance of a transaction . . . To permit the true nature of a transaction to be disguised by mere formalisms, which exist solely to alter tax liabilities, would seriously impair the effective administration of the tax policies of Congress.

In short, with respect to tax matters, "transactions, which do not vary control or change the flow of economic benefits, are to be dismissed from consideration." _Higgins v. Smith_, 308 U.S. 473, 476, 60 S. Ct. 355, 357 (1940).

In the case before us, although they established a trust and then transferred title to their real and personal property to that trust, taxpayers retained the full use of their assets through leaseback arrangements.[6] Although the Balis Trust resulted in service payments to taxpayers and leaseback arrangements, the only substantive effect of the trust was that taxpayer's personal activities became, on paper, trust activities. Taxpayers' assertion that they created the trust to avoid lengthy probate proceedings is disproved by the fact that the Declaration establishing the trust did not explicitly designate beneficiaries.

In sum, as stated by the Tax Court:

> [Taxpayers] . . . have not shown that the transactions at issue had any present economic effect other than income tax savings. Operation of the businesses and occupation and maintenance of the family home continued in the same fashion after the transfer of the properties into the trust as before the transfers. The Court concludes that the transfer of legal title to the properties was done merely to support petitioners' claims of deductions for depreciation on petitioners' residence and rent for petitioners' use of the business property that would not have been otherwise available. The transactions lacked economic substance and are, therefore, not valid for tax purposes.

The record supports this finding, and we conclude, therefore, that it is not clearly erroneous. The creation of the Balis Trust and leaseback of Balis property to taxpayers constitutes

---

[6] This court has held that, where an obligation to pay rent is created by means of a prearranged conveyance and leaseback, rental payments by the grantor-taxpayer are not ordinary and necessary business expenditures required to be made by taxpayers pursuant to section 162(a)(3) of the Code. See Mathews v. Commissioner, 520 F.2d 323, 325 (5th Cir. 1975) (rejecting taxpayer's claimed rental deductions and assertion that there was some business purpose for the transfer of property and its leaseback), cert. denied, 424 U.S. 967, 96 S. Ct. 1463 (1976); see also Audano v. United States, 428 F.2d 251, 256-57 (5th Cir. 1970); Van Zandt v. Commissioner, 341 F.2d 440, 442-43 (5th Cir.), cert. denied, 382 U.S. 814, 86 S. Ct. 32 (1965).

little more than "a purported transfer which gives off an unmistakenly hollow sound when it is tapped." United States v. General Geophysical Co., 296 F.2d 86, 89 (5th Cir. 1961), cert. denied, 369 U.S. 849, 82 S. Ct. 932 (1967); see Zmuda, 731 F.2d at 1421-22 (In evaluating a similar trust arrangement, holding that taxpayers "simply restructured the form in which they hold their property."); Schulz, 686 F.2d at 492 (describing a similar trust arrangement as "a transparent attempt to alter [the] state of affairs by turning all the family activities and all the families' expenses into expenses of trust administration"); see also Neely, 775 F.2d at 1094 (recognizing importance of the fact that taxpayers retained same use of assets as they enjoyed prior to the conveyances).

C

Finally, taxpayers assert that the government is estopped from challenging the validity of the Balis Trust because the Internal Revenue Service has, in previous years, accepted the Balis Trust's Form 1041 Income Tax Returns. We conclude that, despite its previous acceptance of the Balis Trust's returns, the Government is not estopped from challenging the validity of taxpayer's transactions. See Dickman v. Commissioner, 465 U.S. 330, 342-43, 104 S. Ct. 1086, 1094 (1984) ("It is well established that the Commissioner may change an earlier interpretation of the law, even if such a change is made retroactive in effect."); Dixon v. United States, 381 U.S. 68, 72-73, 85 S. Ct. 1301, 1304 (1965) (The Commissioner may retroactively correct mistakes of law "even where a taxpayer may have relied to his detriment on a Commissioner's mistake."); see also Office of Personnel Management v. Richmond, 496 U.S. 414, 419-24, 110 S. Ct. 2465, 2467 (1990) ("From our earliest cases, we have recognized that equitable estoppel will not lie against the Government as it lies against private litigants.").

III

For the foregoing reasons, we AFFIRM the Tax Court's determination that the transactions between taxpayers and the trust they created constitute transactions which are not recognizable for federal tax purposes. We also AFFIRM the Tax Court's (1) disallowance of deductions under the trust claimed by taxpayers, (2) decision to tax taxpayers on the income from assets transferred to the trust, and (3) imposition of additions to tax pursuant to 26 U.S.C. §§ 6653(a)(1) & (a)(2) for 1982 and 1983.[7] Moreover, we order taxpayers to bear the cost of this appeal.

---

[7] Taxpayers have not expressly challenged the district court's imposition of additions to tax for the years 1982 and 1983, so we accept the Tax Court's determination. See Atwood v. Union Carbide Corp., 847 F.2d 278, 280 (5th Cir. 1988) ("[I]ssues not briefed, or set forth in the list of issues presented, are waived.") (citations omitted), cert. denied, 489 U.S. 1079, 109 S. Ct. 1531 (1989).