View metadata, citation and similar papers at core.ac.uk
brought to you by CORE
provided by Notre Dame Law School: NDLScholarship

Notre Dame Law Review

Volume 35 | Issue 1 Article 5

12-1-1959

Income Tax -- Federal -- Tax Status of Permanent Improvements Under a Business Lease

Paul B. Coffey

Follow this and additional works at: http://scholarship.law.nd.edu/ndlr

Part of the Law Commons

Recommended Citation

Paul B. Coffey, *Income Tax -- Federal -- Tax Status of Permanent Improvements Under a Business Lease*, 35 Notre Dame L. Rev. 116 (1959).
Available at: http://scholarship.law.nd.edu/ndlr/vol35/iss1/5

This Note is brought to you for free and open access by NDLScholarship. It has been accepted for inclusion in Notre Dame Law Review by an authorized administrator of NDLScholarship. For more information, please contact lawdr@nd.edu.

INCOME TAX — FEDERAL — TAX STATUS OF PERMANENT IMPROVEMENTS UNDER A BUSINESS LEASE

Introduction

In drafting the modern business lease, many future tax difficulties may be avoided by an awareness of the tax status of improvements which the lessor or the lessee may construct and maintain on the property by mutual agreement. This Note will attempt to present an explanation of these tax implications. Particular emphasis will be placed on the theories underlying the decisions in this area, and the practical considerations which should be considered in relation to projected improvements, particularly at the drafting stage of the lease. The Note is divided into three sections: (1) the status of the lessor's improvements, (2) the lessee's improvements, and (3) the consequences of the lessee's improvements to both the lessor's and the lessee's successors in interest.

Before discussing the various aspects of the problem, it is well to note some specific points. First, we will be dealing with business property, *viz.*, income producing improvements. As such, depreciation[1] and amortization[2] allowances will be permitted, and will be a major problem confronting the draftsman. Second, a consideration of the tax aspects involved assumes that the preliminary questions of accession of the lessee's improvements to the lessor and their status as part of the realty have already been resolved,[3] and that these improvements are permanent, belonging to the lessor at the termination of the lease. If the improvements are to remain the property of the lessee, and are to be removed by him upon termination of the lease, then the tax problem is a minor one. The lessee will be able to depreciate his improvements as ordinary business assets, just as if they were in his own establishment, with no relevancy attaching to the lease, since the lessor will have no interest in the improvements. Third, the status of trade-fixture improvements will not be considered in this Note. Here it is well to note that if trade-fixtures are considered the personal property of the tenant, it may determine whether a state real or personal property tax will be assessed.[4] This, however, is a separate problem which will not be considered here. Suffice it to say that the draftsman of a business lease should determine his state's property tax law on trade-fixtures before deciding to delete a provision in the lease determining the real versus personal property question.

I. THE STATUS OF THE LESSOR'S IMPROVEMENTS

When a lessor improves his property before leasing it, he is able to deduct an aliquot part of the cost thereof during each year of the estimated useful life of the improvement, thus recovering the capital investment through depreciation. For example, a building costing $10,000 having an estimated useful life of ten years and constituting income-producing property would allow a straight-line depreciation deduction of $1000 per year for each taxable year of the improvement's useful life. Although the improvement might still be in use at the end of the ten years, further depreciation would not be allowed. This is in accordance with the basic accounting theory that depreciation is not an attempt to analyze replacement costs, but is rather an attempt to charge asset costs against operations.[5] This depreciation is deductible by the lessor even though the property as improved is in the hands of a lessee, since the lessor has a basis in the property in his costs of constructing it, and it is income-producing property as to him through the rents it produces. Both requisites of depreciability under section 167 of the Internal Revenue Code (*i.e.*, basis and depreciable interest) are met.

---

1 See INT. REV. CODE of 1954, § 167(a)-(f).

2 See INT. REV. CODE of 1954, § 178.

3 See generally, 2 TIFFANY, REAL PROPERTY, § 616-26, (3d ed. 1939); 5 AMERICAN LAW OF PROPERTY, § 19 (Casner ed. 1952).

4 See 5 AMERICAN LAW OF PROPERTY, § 19.13 (Casner ed. 1952). The problem of real — personal property in terms of state rules does not exist in the federal income tax laws, since in interpreting the Code, the courts look to the substance of the transaction, not to state rules. See 10 MERTENS, LAW OF FEDERAL INCOME TAXATION §§ 61.01-61.09 (1958).

5 FINNEY & MILLER, PRINCIPLES OF ACCOUNTING — INTERMEDIATE, 440 (4th ed. 1951).

Tax problems occur in determining the period over which the improvements are to be depreciated, however, when they are constructed by the lessor specifically for the use of one lessee and as an inducement to him to lease the property. It has been argued that if the improvements will have use to no one but the lessee, they should be amortized over the life of the lease, even if their expected life exceeds it.[6] This appears to be a reasonable approach, since if the improvement is to be useless (*i.e.*, no longer capable of producing income) to the lessor after the lease expires, then the lessor should be allowed to take a realistic approach in amortizing the improvement's total cost over the period in which it *is* producing income. This is in apparent conflict with Income Tax Regulation 1.167 (a)(4),[7] which states: "Capital expenditures made by a lessor for the erection of . . . improvements shall . . . be recovered by him over the estimated life of the improvements without regard to the period of the lease." This statement seems to preclude amortization of such improvements over the life of the lease. Prior to the enactment of the 1956 regulation,[8] however, *Laurene Walker Berger*,[9] a Tax Court decision, had phrased the allowance in terms of amortization over the life of the lease. But, today this approach would appear no longer legally sound.

The *Berger* case is more interesting in another aspect, however. There the Tax Court allowed a recovery of capital over the period of the lease on what might appear to be a "negative improvement" — the razing of a building on the property in order to make that property desirable to the lessee, who wished to construct a parking lot. The Tax Court permitted amortization of the undepreciated basis of the building over the lease period, holding that such cost was properly a cost of obtaining the lease. It might seem, then, that the concept of "improvement" is broadly interpreted to comprehend almost any economic loss to the lessor which will make the premises more desirable to a proposed lessee.

But it seems a better view of the case would be to consider the undepreciated cost of the razed building as not really in the nature of an improvement, but as a cost to obtain a lease, such as broker's fees or attorney's fees. Thus it would be amortizable over the lease term without any consideration of the "estimated life" problem. Whichever view is taken, the case resolves the question of deductions for amortization of razed structures in favor of the lessor.[10]

Under the ordinary situation the lessor will be able to deduct depreciation for his income producing improvements on the leased property, whether or not the improvements were made to attract a lessee. But, where the lessee agrees to maintain and repair the improvements, *so as to return them in the same condition as received,* the lessor sacrifices his depreciation deduction in favor of an expense deduction granted to the lessee. In *Commissioner v. Terre Haute Electric Co*[11] this proposition was graphically illustrated by the Seventh Circuit's denial of the depreciation deduction to a lessor who leased his property for 999 years, with the lessee covenanting to "renew, repair and replace same, so as to maintain and keep the demised premises in as good order, repair and condition as same are now. . . ." The court based its decision on *Weiss v. Wiener*,[12] which held that loss to the taxpayer is the reason for depreciation allowances and pointed out that under the terms of the lease, the lessee was to rectify all losses which the taxpayer might incur and since no loss to the lessor would occur he would be denied any recoupment through depreciation. This case does not represent too startling an analysis, since under a 999 year lease,

---

6 Schlesinger, *Problems of Operating Large Structures,* N.Y.U. 14th INST. ON FED. TAX. 279-85 (1956).

7 U.S. Treas. Reg. § 1.167 (a)-4 (1956).

8 *Ibid.*

9 Laurene Walker Berger, 7 T.C. 1339 (1946).

10 The same advantages do not apply to the lessor's successor in interest. See pp. 126-28 *infra.*

11 67 F.2d 697 (7th Cir. 1933), *cert. denied,* 292 U.S. 624 (1934).

12 279 U.S. 333 (1929).

the lessor has, practically speaking, *sold* his property, and depreciation should not be allowed. This reasoning has been paralleled in later cases where the transaction was a more clear-cut lease problem. In *Ben Turchin*,[13] the Tax Court denied depreciation to the lessor under a lease of hotel property and fixtures, where there was a covenant on the part of the lessee to "restore the premises to the same condition as that existing at the time of entering upon same. . . ." In addition, the lessee had paid the lessor $59,000 by way of settlement of restoration fee demands for destruction of the property. The court, in holding that no lessor depreciation was allowable, again based the decision on the ground that no loss had occurred to the lessor because of the restoration damages paid by the lessee.

What is actually occurring in these "return in the same condition" cases is indicated by *Commissioner v. Saltonstall*,[14] where the court held that a taxpayer could resume depreciation on property when its possession had been returned to him. Although the case did not relate specifically to a "return to the same condition" clause, it is significant in that here the taxpayer leased property, did not depreciate it during the period in which it was outstanding, but attempted to depreciate it when it returned to him, and was upheld in so doing by the First Circuit. It is apparent that when a lessor is denied depreciation during the period of the lease, such denial actually *defers* the depreciation to a period to begin at the end of the lease, as occurred in *Saltonstall*. For the tacit assumption in these cases is that the property, returned to the lessor in its original condition, has not had its useful life diminished during the period when the lessee occupied and repaired it. So if it had a fifty-year life at the beginning of the lease, it should have a fifty-year life at the expiration thereof, and the lessor could begin depreciating it at that time, over the fifty-year period. If the property is not returned in the same condition, then, following the reasoning of *Turchin* and *Saltonstall*, it would appear that the lessor would only have a cause of action for breach of covenant against the lessee, since the claim for repairs has been substituted for the depreciation deduction.

Notably, the reasoning outlined above may run afoul of the realities of the lessee's failure to improve, making ordinary improvements and repairs but refusing to be bound to major replacements. It appears that the courts have recognized this problem, and have therefore denied depreciation only in the cases where it is unquestionable that the lessee must return to the lessor exactly what he received from him. For example, in *Terminal Realty Corp.*[15] the lessor was allowed depreciation on his improvements in the face of a lease provision stating: "The [lessees] . . . covenant and agree to keep and maintain the demised property in a good and safe condition, equally as good and safe as the same may be at this time or may be put at any time during this lease. . . ." The court, interpreting the lease provision narrowly, held that here the lessee was required to make only ordinary repairs. In the absence of a "return in the same condition" clause, however, obsolescence is not compensated for by the lessee, although the lessee may be making ordinary improvements, so the taxpayer-lessor is entitled to a deduction for depreciation. Again, in *Commissioner v. Alaska Realty Co.*[16] the same narrow interpretation of a lease clause for repair is evident. Following the *Terminal* case, the court allowed depreciation by the lessor, in the absence of a "return in the same condition" clause in the lease, since the covenant did not cover ordinary obsolescence.

It seems, then, that the lease draftsman should be wary of clauses requiring repairs on the part of the lessee and, although the courts will interpret these narrowly, should never place a "return in the same condition" clause in the lease unless the lessor is willing to part with his depreciation deduction on improvements during the lease term.

---

13 16 T.C. 1183 (1951).
14 124 F.2d 110 (1st Cir. 1941).
15 32 B.T.A. 623 (1935).
16 141 F.2d 675 (6th Cir. 1944).

II. THE STATUS OF THE LESSEE'S IMPROVEMENTS:

Improvements by the lessee, whether bargained for or merely permitted, pose several major tax problems to both lessor and lessee. At the outset, two problems are evident from the lessor's point of view. First, are such improvements, when merely *permitted* by the lessor and not *required* as part of the lease consideration, properly includable in income for tax purposes? Second, assuming the lessee's improvements are properly includable as income, are they income in the year of lease termination, when they actually pass to the lessor, or in the year of construction?

At first glance, it would appear that improvements built by a lessee which will pass to the lessor upon lease termination are income to the lessor. Since he will receive property at the end of the lease which he did not possess at the beginning, he realizes a value from the lease, over and above the rent he charges. This position was taken by the Supreme Court in *Helvering v. Bruun*,[17] which held that a lessor, receiving improvements from a forfeiture of a leasehold, realized income for federal tax purposes. In this case the Court rejected the lessor's argument that the claimed gain was not severable from the value of the property and that no specific valuation could be assigned to the improvement erected by the lessee, since it had become an inseparable part of the estate leased. As such, claimed the lessor, the value had become an additional increment of capital, and, therefore, should not be treated as income until realized by gain on the sale of the property. The *Bruun* case is particularly interesting when compared to *Commissioner v. Hewitt Realty Co.*,[18] where the Second Circuit, five years before *Bruun*, had considered essentially the same problem, and had arrived at an opposite result. In *Hewitt*, the lessee had constructed a building on the leasehold, which was to become the property of the lessor at construction, by covenant in the lease. The Commissioner had held that one year's aliquot part of the total value of the improvement was income. The Second Circuit reversed, holding that no income was realized, but merely an increase in capital value, such as might arise from the bettering of the neighborhood of the leasehold. Significantly, the improvement here was not in the nature of rent, but was built by permission of the lessor. According to Judge Hand, the increased value received from the lessee's improvement could only be determined with any degree of accuracy upon the sale of the property. By analogy, if property were purchased and a basis for capital gains purposes was determined at cost, and later betterments took place in the neighborhood which enhanced the value of the property, such added increments in value would be taxable as capital gains only when such "paper profits" finally crystallized into actual gains by the sale of the property at a price in excess of the determined cost. Notably, the actual value of the betterment, or improvement, could not be determined until an actual gain was realized through the utilization of the value increment by its sale. But even then, it would be impossible to apportion the sale price between the original property and the betterment — the two would, as the lessor's counsel in the *Bruun case* maintained, be inseparable. Judge Hand, in the *Hewitt case*, held that such improvements, being in the nature of intangible neighborhood betterments, should not be taxed as income either in the year of construction or in the year of termination of the lease. Judge Chase, dissenting in *Hewitt*, claimed that the improvement itself was rent, and thus taxable as current income. He based his reasoning on the proposition that the lessee was in effect paying for the right to build by forfeiting the improvement. But notably, Judge Chase did not attack the capital improvement argument of Judge Hand — even the dissenter in this case would apparently hold with the majority if he were satisfied that there was no rent element involved.

However the reasoning in *Hewitt* was rejected by the Supreme Court in *Bruun*, so it became the rule that the lessee's improvements were taxable to the lessor as

---

17 309 U.S. 461 (1940).
18 76 F.2d 880 (2d Cir. 1935).

income, whether such improvements were treated as rent or not. *Helvering v. Bruun* was consistently followed[19] until 1942, when section 109[20] of the present code was enacted. This section treats all improvements by a tenant which pass to the lessor as merely additions to capital, unless such were clearly rent.

Thus, it appears that whether or not Congress accepted the reasoning of Judge Hand in the *Hewitt* case, the final result is the same. Improvements of the lessee, if not required as rent, are non-taxable additions to the value of the leasehold until realized as a capital gain by the lessor. This result is the same regardless of whether the termination is by expiration or by forfeiture, or whether the termination is at the time originally contemplated by the lessor and lessee or not.[21]

In determining what improvements are taxable as income, that is, what is *rent,* the courts, in effect, have been very demanding in the "proof" required of the Commissioner. In *M. E. Blatt Co. v. United States,*[22] the Supreme Court stated that, "Even when required, improvements by lessee will not be deemed rent unless the intention that they shall be is plainly disclosed." [23] This test, according to *Blatt,* seems to be based upon the theory that rent is in the nature of a fixed and predetermined sum, to be paid at stated dates, not something so inestimable as a building or other improvement on the leasehold.[24]

The *Blatt* test remains intact today, after being clarified somewhat in *Cleveland Trust Co., Trustee,*[25] where the intent to include improvements as rent was held not to be plainly disclosed, and in *Commissioner v. Cunningham,*[26] where the disclosure of intent was held to be wanting in view not only of the agreement itself, but also of "surrounding factors" such as the treatment of the transaction by the parties to the lease. Grouping section 109, Regulation 1.109-1, and the *Blatt* case and those decisions following it, it is apparent that the present law on determining what improvements made by the lessee are income is liberally construed in favor of the lessor-taxpayer.

A word of caution, however, is in order to lessors who require replacement of depreciating property by the lessee. Such lessors would do well to keep any excess of settlement funds paid in lieu of replacements separate from the full cost of the actual replacements made. The lessor must show that settlement funds are actually applicable to replacements or they will be taxed as income. In *Washington Fireproof Building Co.,*[27] the lessee fulfilled his agreement to replace depreciated property by a lump-sum payment of $39,000. The Tax Court held that the amount in excess of actual replacement expense was income in the nature of rent, reasoning that first, a replacement cost payment would not be income, but a return of capital, yet the burden of showing that this payment is actually for replacement is on the taxpayer,[28] and second, if it were possible to determine the excess of the amount received over replacement costs, only that amount would be taxable, but since the lessor did not sustain this burden, and show the excess, the entire amount would be taxable as income, except for the amount actually spent on replacements.

---

19 See Greenwood Packing Plant v. Commissioner, 131 F.2d 787 (4th Cir. 1942); Commissioner v. Hills Corp., 115 F.2d 322 (10th Cir. 1940); Joseph Kennard Skillings, 41 B.T.A. 888 (1940); Estate of Austin C. Brant, 44 B.T.A. 1306 (1941).

20 INT. REV. CODE of 1954 § 109 states: "Gross income does not include income (other than rent) derived by a lessor of real property on the termination of a lease, representing the value of such property attributable to buildings erected or other improvements made by the lessee."

21 Commissioner v. Cunningham, 258 F.2d 231 (9th Cir. 1958); U.S. Treas. Reg. § 1.109-1 (a) (1956).

22 305 U.S. 267 (1938).

23 *Id.* at 277. *Accord,* Duffy v. Central R.R., 268 U.S. 55 (1925).

24 *Ibid.*

25 39 B.T.A. 113 (1939).

26 258 F.2d 231 (9th Cir. 1958).

27 31 B.T.A. 824 (1934).

28 *Id.* at 827; *accord,* Cataract Ice Co., 23 B.T.A. 654 (1931).

In contrast to this extreme position, but following the same reasoning to a contrary result, is *Hamilton and Main, Inc.*[29] There, with an effective showing that the lump-sum settlement payment was equal to the amount of repairs made, the court held such a settlement to be merely a return of capital, and as such, not taxable as income.

Section 109 of the Internal Revenue Code, although it repudiates the treatment of the lessee's improvements as income to the lessor, does not allow the lessor to receive such improvements completely tax-free. It is well to note that such improvements are not added to the lessor's basis of the property for either depreciation purposes or for capital gains computation purposes. Section 1019 of the 1954 Code, as amended, states: "Neither the basis nor the adjusted basis of any portion of real property shall, in the case of the lessor of such property, be increased or diminished on account of income derived by the lessor in respect of such property and excludable from gross income under section 109. . . ."

Hence, if the lessee builds improvements on the lessor's property, and such improvements are not rent, they are not taxable as income either in the year of construction or at lease termination, when they will become the property of the lessor. But the lessor *will* be taxed at capital gains rates upon the sale of the property, since he will be taxed on the additional increment of value represented by the improvements, which cannot be added to his adjusted basis.[30] For example: If the lessee builds improvements worth $50,000 on a $100,000 leasehold, such improvements not being rent, and such improvements pass to lessor at the lease's termination, the improvements will not be taxable as income. But upon sale of the leasehold, assuming its market value has been increased $50,000, the receipt would be $150,000. The basis would remain at $100,000 and thus the lessor would be taxed at capital gains rates on $50,000. This situation is in accord with Judge Hand's reasoning in the *Hewitt* case — the taxation of the improvement has been treated exactly as if it were in the nature of an intangible enhancement of property value, such as a neighborhood betterment would be — the income has been deferred, until its actual value has been determined. But significantly, since capital gains taxation rates are lower than income taxation rates, the lessor has realized an advantage from this position, as opposed to the result under the *Bruun* case. But, considering the realities of the situation, such an advantage appears justified for, although the lessee may have spent $50,000 to construct the improvement, its value may not be that high upon transfer to the lessor, and under the *Bruun* rule the lessor would probably be taxed at surtax rates on the full $50,000. Again, the value of the improvement will probably decline before sale of the property by the lessor, since the lessee will have made extensive use of it. And in leases where improvements are involved, the lease term is usually comparatively long, thus a considerable period of time will probably elapse before the lessor will be able to dispose of the property. Considering these factors, it appears that the section 109 rule is wise since it treats the lessee's improvements realistically by deferring the income therefrom until it is actually realized by the lessor.

On the other hand, the logical extension of the rule, reflected in both sections 109 and 1019 of the Code, would require improvements which are made by a lessee in lieu of rent to be taxable as ordinary income. Also, since such improvements are taxed as ordinary income, they are properly includable as capital investment items, and are proper additions to the adjusted basis of the leasehold.[31] That this is the realistic approach is apparent when we realize that in such a case the lessor is, in effect, selling the use of his property to obtain a further capital investment in lieu of using his own funds to improve the property.

29 25 T.C. 878 (1956).
30 See Int. Rev. Code of 1954, §§ 109, 1019; U.S. Treas. Reg. §§ 1.109-1 (1956), 1.1019-1 (1957).
31 Int. Rev. Code of 1954, §§ 1011, 1019.

Therefore, the lessor can have one of two choices: (1) allow the lessee to construct improvements which will pass to the lessor upon lease termination, without taxation as income, but with probable taxation as a capital gain, or (2) require such improvements of the lessee as rent, and pay an ordinary income tax on them, with a corresponding increase in the lessor's adjusted basis of the property for capital gains purposes. The draftsman should keep these choices in mind, and be certain that his phraseology places the status of improvements by the lessee clearly in one of the above categories. Perhaps the best way in which the lessor can secure an advantage under the present Code would be to permit the improvements, not require them as rent, and then use them himself upon lease termination, until their useful life has expired, before selling the property. The lessor should generally attempt to utilize the capital gains advantage permitted him by employing the permissive, rather than compulsory, improvement.[32]

Assuming, however, that the improvements are properly taxable to the lessor as rent, it is well to examine the question of *when* they are taxable — in the year of completion, or in the year of lease termination. This problem has been a difficult one for the courts since 1919 when it first arose in the case of *Miller v. Gearin*.[33] In that case, the Ninth Circuit held, in reasoning which is still accepted in the rent problem area today, that if leasehold improvements are to be income to the lessor, they are income in the year of construction. The improvements become the property of the lessor at construction, and the lessor merely gets the possession of what he already owns in the year of lease termination. Although the *Miller* case, and the line of cases following it, are not all cases in which the improvements are treated as rent, they are relevant to a consideration of the effect of rent-improvements today, simply because they all assume the issue that the improvements are taxable. For example, the case of *Joseph L. B. Alexander*,[34] which is not a rental case but one assuming the lessee's improvements to be income to the lessor, holds that such income is taxable in the year of improvement construction, whether the lessor is on the cash or the accrual basis of accounting. In that case, a taxpayer-lessor who kept his books on the cash basis, not recording income until actually received, regardless of when earned, argued that the improvements of his lessee were not income in the year of construction, since they were not received until the year of lease termination. The court rejected this argument, holding that the mandate of *Miller v. Gearin* required that improvements be treated as income in the year of their construction, regardless of the particular accounting methods of the taxpayer. By comparison, there is the more current case of *Brown v. Commissioner*,[35] where again a cash basis taxpayer attempted to assert that the rent which she received from a lessee by way of his improvement was not taxable as income, since she kept her books on the cash basis. The court held, on the same reasoning as in the *Alexander* case, that the amount of such improvement was properly taxable as rent in the year earned, regardless of when actually received.[36]

The *Miller* approach was again emphasized with regard to a rental situation in *Durkheimer Investment Co.*, where the Board of Tax Appeals, dealing with a rent-improvement situation, and relying explicitly on the *Miller* case, held the lessee's improvements to be income to the lessor in the year of construction.[37]

---

32 Under INT. REV. CODE of 1954, § 1202, capital gains rates will generally be considerably lower than corresponding income tax rates.

33 258 Fed. 225 (9th Cir. 1919).

34 13 B.T.A. 1169 (1928).

35 220 F.2d 12 (1955).

36 This case represents an extremely interesting fact situation in the area of joint improvements of the lessor and the lessee. Here the lessor agreed to contribute to the construction of improvements, partly in cash and partly by rent credits. She did so, and then claimed the rent credit, which was actually in the nature of an improvement in lieu of rent, was not taxable in the year the credit was given, the same year as the improvement was built.

37 36 B.T.A. 423 (1937); *accord*, Julia Willms Sloan, 36 B.T.A. 370 (1937); Louise C. Slack, 35 B.T.A. 271 (1937).

In 1938, the landmark case of *M. E. Blatt Co. v. United States*[38] held, assuming that improvements other than rent were income, that there was no rental element in the improvements under consideration, and that the improvements, if income at all, were taxable at lease termination, and could not be taxed during the lease term. Since the assumption of the *Blatt* case, *i.e.*, that income includes improvements other than rent, has been foreclosed to the contrary by section 109 of the Code, the only type of improvement upon which the *Blatt* rule could be operative is rent improvements. And since rent improvements, under the Code, are held taxable in the year of construction as advance rental payments,[39] the *Miller* rule seems to apply to the only type of lessee's improvements which are income to the lessor. As such, the *Blatt* case is stripped of much of its meaning, but it is still important in that it sets down the test to determine when improvements are rent, a test which is very liberal to the lessor.

Let us now examine the status of the lessee in a situation where he (1) improves the property by requirement of the lessor, as rent, or (2) improves the property by permission, not as rent. In the first situation, where the improvements are rent, the lessee has a deduction over the period of the lease for the expense involved.[40] This deduction springs from the treatment of the improvements as an ordinary item of rent expense, and as such, it is deductible as a business expense of the lessee over the period of the lease.[41] The theory of the *Main* case, and the reason for the spreading of the rental, is simply that such improvement is a payment benefiting the lessee over the entire lease period, and thus should be shown as an expense over that period. Conversely, as indicated previously, the lessor now has an addition to his basis for depreciation, and can depreciate the fair market value of the lessee's improvements over their useful life.

But in the second situation, where the lessee improves the property by the lessor's permission, and not as rent, difficult depreciation problems arise. Of course, it is generally accepted that the lessee may depreciate the improvement since it is in the nature of a capital investment made by him — just as though he had built an improvement on his own property. Notably, the previously mentioned criteria of the *Blatt* case for distinguishing rental improvements from merely permissive improvements applies here — that is, the distinguishing factor is the intent of the parties, as manifested by all surrounding circumstances, with the tendency being toward a very narrow interpretation of rent improvements.[42] In addition to the problem of determining whether or not the improvements are rental or merely permissive, there is the much-litigated question of the proper depreciation period — will the improvements be depreciated over the term of the lease, or the life of the improvement? Generally, it is held that improvements depreciable by the lessee are to be depreciated over the life of the improvements or over the lease term, whichever is shorter.[43] The problem, however, occurs in determining the life of the lease where an option to purchase exists, or options to renew are present. In the *Leonard Refineries*[44] case, the Tax Court held that where the lessee leased property, erected improvements, and later bought the leased property under an option to purchase, the lessee should have been depreciating the improvements over their useful lives without regard to the term of the lease. The test used by the court is the generally accepted method employed in the option situation. It is a test that might be characterized as "retrospective probability." The court looked in retrospect to the period in question, where the exercise of the option was uncertain, and analyzed the proba-

---

38 305 U.S. 267 (1938).
39 INT. REV. CODE of 1954 § 61 (a) (5); U.S. Treas. Reg. § 1.61-3 (c) (1958).
40 INT. REV. CODE of 1954, § 162 (a) (3).
41 Main & McKinney Bldg. Co. v. Commissioner, 113 F.2d 81 (5th Cir. 1940); *accord*, Your Health Club, 4 T.C. 385 (1944).
42 See Duffy v. Central R.R., 268 U.S. 55 (1925).
43 U.S. Treas. Reg. § 1.167 (a) (4) (1956).
44 11 T.C. 1000 (1948).

bilities of the exercise of the option. The court then went on to conclude that it was obvious at the time in question that the corporation would exercise its option to buy. Also significant in this area, dealing specifically with renewal options rather than purchase options, are the cases which *Leonard Refineries* followed.[45]

Perhaps it might be argued that, in this retrospective view, the courts could always conclude in accord with the present realities of the situation, *i.e.*, whether the lease option has actually been exercised, without regard to the probability of it being so exercised at the time the depreciation or amortization method was adopted. But the courts disclaim any such attitude, as in *1620 Broadway Corp.*,[46] where the Board of Tax Appeals expressly refused to use its present knowledge of the ultimate exercise of the renewal option, and dealt with the probabilities of the situation at the time the option exercise was still in the offing, and the depreciation was set up on the basis of the life of the improvements. Again, in *Bonwit Teller v. Commissioner*,[47] where the Second Circuit had no knowledge of the ultimate resolution of the option issue, the court accepted the challenge of retrospective prediction, and analyzed the past probabilities of option exercise, holding that there was no evidence to show that the lease would be renewed, thus amortization was the proper method of handling the write-off of capital value against income.

The *Alamo Broadcasting Co.*[48] case seemed to indicate a more mechanical approach to the problem, with no discussion of the probabilities that the lease option would be renewed. But immediately following it is the case of *Hens & Kelly, Inc.*,[49] which, in denying the argument that a reappraisal clause in the lease (whereby the future rents are to depend on reappraisal at the renewal date of the lease) necessarily dictates the renewal of the lease, vividly exemplifies the determination of the Tax Court to give full vitality to the retrospective probability test in this area. The court held that the renewal was probable, not because of the reappraisal or any fixed rule, but on the basis of the actions of the lessee. The court treats this probability of renewal as a fact question, and determines it as such. *Hens & Kelly* is probably the best present example of the method applied by the Tax Court in this area, and it indicates a heavy emphasis on the facts of the particular situation surrounding the renewal option. Again this approach is apparent in *Jos. N. Neel Co.*,[50] where petitioner-lessee agreed to construct an improvement on the leasehold in the amount of $250,000 and agreed that his failure to do so would alternatively require him to pay the lessor the amount not so expended. The Tax Court held this amount to be deductible over the period of the original lease plus the renewal period, since there was a strong possibility of renewal even though nothing had been built or paid at the time of the decision. In all of these cases the same pattern of decision is apparent. It is an evaluation of renewal possibilities with the decision being based upon what the court thinks the lessee would probably do when he determines whether to depreciate or amortize the improvement in question. If it is apparent that at that time the lessee will exercise his option to purchase or renew the lease, the court will then decide that the asset must be depreciated over its estimated useful life. If, on the other hand, renewal or purchase is improbable the court will hold that amortization is in order, over the original term of the lease, without regard for the life of the improvement.

In the case of the month to month lessee, the problem of depreciation versus amortization is clear. According to *Emma C. McIlwayne*,[51] relying on *Bowman v.*

---

45 Commissioner v. Pittsburgh Union Stockyards Co., 46 F.2d 646 (3d Cir. 1931); 1620 Broadway Corp., 36 B.T.A. 149 (1937).
46 36 B.T.A. 149 (1937).
47 53 F.2d 381 (2d Cir. 1931), *cert. denied,* 284 U.S. 690 (1932).
48 15 T.C. 534 (1950).
49 19 T.C. 305, 303-28 (1952).
50 22 T.C. 1083 (1954).
51 21 P-H Tax Ct. Mem., 861 (1952).

Commissioner,[52] improvements by a month-to-month lessee are depreciable over their estimated life, without regard to any probability of lease continuation. In both cases, the court emphasized that this type of improvement may not be deducted as a business expense in the year of construction, and depreciation based upon the estimated useful life of the improvements is in order. This appears to be the reasonable rule, since there is usually no evidence to resolve the question of how long the lessee will remain on the property, or how long the improvements will remain in his possession. If, however, the lease is to terminate before the improvements have been fully depreciated, then it is apparent that the lessee will be able to deduct the remaining undepreciated value of his capital investment in the improvements as an abandonment loss, according to *McIlwayne*.

The courts have been rather liberal in allowing a write-off of the undepreciated or unamortized improvements of a lessee in the year of the lease termination. That such a write-off is in order is readily seen since the lessee's improvements are treated as a capital asset and are depreciated as such. In the event of an abrupt destruction of the lessee's interest, for example, a premature lease termination, the lessee may write off the loss on capital assets just as he would in the event they burned down. This is indicated in the month-to-month lessee situation, by *McIlwayne*, and is even more clearly exemplified in *Robert Coffey*,[53] where the Board of Tax Appeals allowed the write-off upon lease termination on the probability that the taxpayer made the improvements with an intent to exercise an option to purchase. As such, the court found that the taxpayer's failure to exercise the option deprived him of property which he improved in expectation of ultimate ownership, so the taxpayer sustained a loss. Although this approach is perhaps unique, it is perfectly in accord (in result) with the rule enunciated in *Appeal of Mandel Bros.*,[54] where taxpayer-lessee who had improved the property was forbidden to continue the amortization of the improvements which he had built and then razed under a lease covenant, but was ordered to write off the capital loss on the old improvement at the time his interest in it was destroyed.

In the case of the related lessor and lessee, no problem of depreciation-amortization is present. Under Code section 178,[55] a related lessor-lessee situation will allow the lessee to depreciate his improvements only over their estimated useful life, without regard for the lease term. Apparently this provision was passed to avoid the situation where the lessor, wishing to improve his property, leases it to a related person who then makes the improvement and amortizes his capital investment over the short lease term, and subsequently passes the property back to the lessor. The lessor thereby receives his improvements while the lessee has the advantage of a quick write-off, assuming a short lease term. Under the present Code, such a write-off is defeated.[56]

The situation of the lessee's improvements seems to resolve itself to the following: the lessee's improvements will be income to the lessor only in cases where they are expressly intended as rent,[57] and this intent must be clearly shown. If the lessor desires a depreciable interest in the lessee's improvements, then he will want such improvements to be in the nature of rent. On the other hand, if he wishes to take advantage of the capital gains feature involved in treating the improvements as non-rent items, he will merely permit such improvements, clearly drafting the lease to show that they are not rent. The draftsman advising the lessor would do well to note the alternatives presented to the lessor in this respect and, if desirable, take advantage of the capital gains features permitted rather than seeking a

52 32 F.2d 404 (D.C. Cir. 1929).
53 21 B.T.A. 1242 (1931).
54 4 B.T.A. 341, 350-51 (1926).
55 INT. REV. CODE of 1954, § 178 (b).
56 See INT. REV. CODE of 1954, § 178 (b); *But see*, Fort Wharf Ice Co., 23 T.C. 202 (1954).
57 INT. REV. CODE of 1954, § 109.

depreciable interest in the improvements. This would seem to be the better approach because, in order to get such an interest, the improvements must be in the nature of rent *ab initio*, and thus they would be taxable as ordinary income to the lessor.

The lessee, on the other hand, can begin to deduct the total cost of such improvements upon their construction, if they are rent. But it should be noted that these improvements will be treated as advance rentals, and they must be apportioned over the period of the lease, in spite of the fact that the improvements are income to the lessor in the year of construction. On the other hand, if the improvements are not in the nature of rent, the lessee may depreciate or amortize them, in the ordinary case, over the useful life or over the lease term, whichever is shorter. If the lessee does not fully deduct his capital investment over the lease term, and if there is still an unamortized or undepreciated balance left at lease termination, then such balance is properly deductible as a loss in the year of termination. The draftsman advising the lessee should keep these corresponding alternatives in mind when deciding whether the lease is to require improvements as rental items or permit them as non-rental improvements. Also, he should be careful to clarify any renewal option provision, and advise the lessee to sustain the decision to depreciate over the life of the improvements or amortize over the lease term by a careful evaluation of the probability of exercise of such option to renew or purchase, assuming the life of the improvements extends beyond the lease term. Decisions as to whether the rent deduction or a depreciation deduction or an amortization deduction is desirable to the lessee will vary according to the lessee's desire for a quick write-off or a long-term deduction of the improvement.

III. The Consequences of the Lessee's Improvements to Both Lessor's and Lessee's Successor in Interest

A third problem remains to be treated in discussing the income tax status of leasehold improvements. That is the general problem area of the basis for computing gain from sale and the depreciable interest in the improvements in reference to the successor of the lessor and lessee.

The basic problem involved here is clearly brought out by *First Nat'l Bank of Kansas City v. Nee*,[58] where the lessor's executor attempted to depreciate the lessee's non-rental improvements on the leasehold, which were to revert to the lessor at the termination of the lease. Notably, the lessor had no depreciable interest in the improvements, and would have had no addition to his adjusted basis for the building for capital gains purposes, simply because the lessor had made no capital investment in the building.[59] But, argued the executor, under the provisions of the Code, which include the improvements of the lessee in the estate for estate tax purposes,[60] and by virtue of their inclusion and taxation as such, the improvements should be added to the lessor's successor's basis, and should be depreciable. The court emphasized that

> the controlling inquiry is whether, in the situation under review, regardless of who technically owns the wasting improvements, the claimant of depreciation holds it for the production of income *for the claimant's benefit*, and has in it a cost basis or, within the meaning of the statutes, . . . a substitute basis upon which depreciation may be computed.[61]

Thus the court notes two major elements of depreciation which will be considered here: (1) has the successor-estate a depreciable interest since he holds the property for the production of income for his own benefit, and (2) has he a cost or other acceptable basis for depreciation in the property?[62] Regarding this problem, the

58 190 F.2d 61 (8th Cir. 1951).
59 See Int. Rev. Code of 1954, § 1019, and note 30 *supra*, and accompanying text.
60 Int. Rev. Code of 1939, § 113 (a) (5); now Int. Rev. Code of 1954, § 1014 (a).
61 190 F.2d 61, 68 (1951).
62 This inquiry pertains to current § 1014 (a) of the IRC, which is the same as previous § 113 (a) of the 1939 Code, under which many of the following cases in this discussion were decided.

court in *First National* held that no depreciation is allowable to the successor of the lessor, since the improvements are not income-producing property to him. The improvements may well be taxable for estate tax purposes, and may have a basis for that reason, but basis is only one of the requirements for depreciation. The other element, income production regarding the claimant, is missing, since, as to the claimant, the income producing feature of the lease was the unimproved leasehold. That was what the lessor leased in the first place, and that is the source of the rent income to the successor. This reasoning appears to be in line with *Helvering v. Lazarus and Co.*,[63] where the Supreme Court said, "The Federal Income Tax is aimed at net income determined from gross income, less items such as necessary expenses incurred or capital consumed in earning it." [64] The Court thus allowed a claimant to depreciate property even though legal title was in another, if the taxpayer had a depreciable capital investment. Again, the same test of depreciability is laid down — a capital investment of some sort, giving rise to a basis, and some type of property producing income to the taxpayer from that capital investment. Although the *First National* case bases its rejection of the lessor's successor's depreciation on the element of "no income production," it would seem that a more persuasive approach would be to deny any basis at all for depreciation purposes, since no capital investment has been made, except perhaps the payment of an estate tax.[65] It appears, however, that the courts prefer to base their denial of depreciation on the former ground, that is, that the improvements are not income-producing property to the successor of the lessor. This is evident in *Commissioner v. Moore*[66] which holds the lessor's successor cannot depreciate the lessee's non-rental improvements which will revert to him at termination, even though a basis is provided by the estate tax provision, section 113 (a) of the 1939 Code and section 1014 (a) of the current Code. The court holds that there is no depreciable interest in the lessor or his successor, as to the improvements, since the life of the improvements is shorter than the lease term. Thus, the successor has no interest in a wasting asset, but, in reality, has only a reversionary interest in a building which theoretically is worthless at the end of the lease term. He has a reversion in nothing, to extend the reasoning of the court to its ultimate conclusion. As the facts indicate in *Goelet v. United States*,[67] the improvement was a building which was estimated to have a life of eight years. This life was less than the lease term (10 years) so nothing except the leasehold would revert to the successor at the end of the lease. Theoretically the building would not exist as a useful asset at the end of the lease term. This appears to be the "no income producing property" argument of the *First National Bank* case. For, if there was no improvement on the property when it was leased, and there was none on the property when the lease was terminated, then the income-producing element of the leasehold consists only of the property originally leased, devoid of improvements. The rental amount would be the same, the income would be the same, whether the improvement were on the property or not — because the lessee covenanted to pay a set amount of rent for the leasehold itself — he did not rent the building which he himself built. Several other recent cases, (*e.g.*, *Albert L. Rowan*,[68] and *Commissioner v. Pearson*[69]) indicate the same reasoning. In *Pearson*, the Fifth Circuit held that the only income-producing property which was taxed for estate tax purposes was the original land, exclusive of improvement, and therefore no consideration was given to the improvements as income-producing property. The holding

63 308 U.S. 252 (1939).
64 *Id.* at 254.
65 See also, Bonwit Teller, Inc., 46 B.T.A. 978 (1942).
66 207 F.2d 265 (9th Cir. 1953), *cert. denied* 347 U.S. 942 (1954); *Accord*, Goelet v. United States, 161 F. Supp. 305 (S.D.N.Y. 1958), *aff'd. per curiam*, 266 F.2d 881 (2d Cir. 1959).
67 *Supra*, note 66.
68 22 T.C. 865 (1954).
69 188 F.2d 72 (5th Cir. 1951).

in the *Rowan* case similarly allows no depreciation by the successor, since no income-producing property other than the leasehold, devoid of improvements, can be shown to have been taxed for estate tax purposes. Here, again, we find the same basic idea — the lessor leased only the original property, which is what is producing the income, and that the improvements, not producing income to either the lessor or his successor, are not depreciable by them.

Thus we find that the courts emphasize this "lack of income-producing" property argument in denying depreciability of the lessee's improvements by the lessor's successor. It might have been called the "lack of a wasting asset" in *Moore* and *Goelet,* and the "impossibility to sever the taxable basis of the improvement from that of the original leasehold" in *Pearson* and *Rowan.* But regardless of what it is called, the courts seemingly will not find a depreciable interest in the lessee's improvements for a lessor or his successor, even though as successor he acquires a basis in the property within the meaning of section 1014(a). The courts do not mention the argument that such basis is not supported by an original capital investment by the lessor, but this factor might easily be an undercurrent in their thinking, since it is strongly suggestive of a successor attempting to reap where neither he nor the original lessor have sown. Again, although only mentioned in *Moore,* there would be something anomalous about allowing two people, the lessor's successor and the lessee, to depreciate the same asset simultaneously, and this would be permitted by a contrary rule.[70] Hence, it would appear that the rule of non-depreciability of the lessee's improvements by a lessor's successor is a wise one, but the same reasoning would militate against the sensibility of taxing lessor's successor for estate tax purposes on improvements. Although *Pearson* and *Rowan* evade this by saying that the fair market value of the leasehold, as taxed, might easily be only the original unimproved value of the leasehold, it is an inescapable conclusion that in most cases the lessor's successor will be taxed on an improvement which will never become his by reversion (at least in theory, according to *Moore and Goelet*), since it will have wasted away by the expiration of the lease. Further, the successor cannot compensate himself for this loss through depreciation.

The estate taxation under section 1014 does appear to benefit the successor of the lessor in one way, however, since it allows him to increase his capital gains basis to include the amount of the improvements.[71] This seems to be assumed without conflict in the prior cases discussing the successor's depreciation.

Problems of the lessee's successor seem to be relatively straightforward and minor in this area, assuming that the successor acquires the same interest that the lessee had in the property.[72] If so, the improvements present no apparent problems. In *Cogar v. Commissioner*[73] the right of the lessee's assignee to depreciate the lessee's improvements under the lease was upheld, even though, under the lease, title to these improvements vested in the lessor upon their completion since the right to depreciate is not confined to the owner of a fee. The petitioner-successor here, buying the rights of the lessee to the income-producing improvements, was entitled to depreciate them as the lessee himself, over the remaining term of the lease or the life of the improvements, whichever was shorter.

The liberality of the courts in allowing a lessee's successor to stand in the position of the lessee in regard to improvements is shown vividly in *Millinery Center Bldg. Corp. v. Commissioner,*[74] where the taxpayer-lessee in effect succeeded him-

70 See Charles Bertram Currier, 7 T.C. 980 (1946).
71 Buelterman v. United States, 155 F.2d 597 (8th Cir. 1946).
72 If the successor is a sublessee, the original lessee is placed in the position of a lessor as to the sublessee, and the same considerations regarding lessor's improvements will apply to the two parties, as indicated in Section I of this discussion. Section II of the Note, THE TENANT'S IMPROVEMENTS, will apply as between lessee and sublessee, and will continue to apply between the original lessor and lessee.
73 44 F.2d 554 (6th Cir. 1930), *rehearing denied,* 51 F.2d 501 (1931).
74 221 F.2d 322 (2d Cir. 1955).

self by leasing property, constructing improvements, depreciating them fully over the life of the lease, and then buying the fee from the lessor. The Second Circuit held that the lessee-purchaser *could* depreciate that portion of the purchase price allocable to the building, since "a third party purchaser of such a fee would be entitled to allocate part of its cost to the building and to depreciate it as such." [75] In affirming, the Supreme Court held[76] that petitioner could validly deduct the amount of the purchase price allocable to the improvement, as depreciation, over the remaining useful life of the building.

Conclusion

Although the area of leasehold improvements has been uncertain in the past, the present income tax law in the area has become relatively settled into what is probably the most reasonable and fair solution to the problems involved. The law is reasonably certain since sections 109 and 1019 of the present Code resolve questions of income to the lessor upon the lessee's improving the land, and the problem of basis in this area.

The basic rules to be mastered by the draftsman of leases in this area, then, are: (1) where the improvements of the lessee are not intended as rentals, they are not taxable to the lessor either at construction or at lease termination; but on the other hand, they are not depreciable by the lessor, nor do they increase his adjusted basis in the property. Conversely, this type of improvement is depreciable by the lessee over either the period of the lease or the life of the improvement, whichever is shorter.

(2) If the improvements are intended as rent (under the *Blatt* rule this intent must clearly be shown), then they are taxable as income to the lessor, they are depreciable by him over their estimated life, and they do increase his adjusted basis for capital gains purposes. Conversely, the lessee does not have a depreciable interest in the property, but will get a deduction for the investment in improvements by way of a pro-rata deduction of the cost of the improvement over the life of the lease, as rent expense.

The lease draftsman should indicate these alternatives to both lessor and lessee, allowing them to decide whether to consider the improvements as rent according to their particular business needs and their present deduction position.

Uncertainty in the law, however, is apparent in certain areas of improvements, primarily in cases where the lessee has agreed to repair and maintain improvements of the lessor, where renewal or purchase options are present in the lease, and where the rights of the lessor's and the lessee's successors in interest, in regard to depreciation of the improvements and acquisition of a basis for depreciation and capital gains purposes within the estate tax valuation of the improvements are concerned. Here prudence must be exercised.

Where the lessee has agreed to repair and maintain the improvements of the lessor, the danger is that a clause requiring the lessee to "return the property to the lessor in its original condition" might be inserted without realizing its full import. The courts have interpreted repair clauses very narrowly, and have seldom found a clause which does not explicitly provide for the return in the same condition to be a reason for denying the lessor his depreciation on the improvements. But it must be kept in mind that if the lessor requires the lessee to make such replacements, the lessor will not be able to depreciate the property during the term of the lease, for the asset will not be wasting if lessee is keeping it in its original condition. Repair clauses will not preclude the lessor's depreciation, however, as long as they do not demand this "original condition" of the property at its return.

Problems arise as to renewal and purchase options in a lease, in determining whether an improvement built by a lessee, with a useful life of longer than the

75 *Id.* at 324.
76 350 U.S. 456 (1956).

lease term, are to be depreciated over that life or amortized over the lease term. Here the problem is almost completely a matter of judicial interpretation, with the courts using the retrospective probability approach and is determined by the probability of lease renewal at the time that the depreciation-amortization decision is made. If the probability is that the lease will be renewed or the option exercised, the improvement must be depreciated over its life — if non-renewal is expected, amortization over the lease term is proper. Although a lease draftsman cannot ascertain this probability at the drafting stage, he should counsel the parties to the lease at its inception to support their depreciation-amortization decisions by evidence of probable renewal or non-renewal.

As regards the lessor's successor, there are advantages available which were not available to his predecessor. The successor will acquire a basis for capital gains purposes in the improvements built by the lessee under the lease. Assuming they are non-rental improvements, this is a basis which the original lessor never possessed. This basis is acquired by reason of the estate tax valuation of the property. But this basis is not enough to give the lessor's successor a depreciable interest in the property — for the improvements are not income-producing property as to the successor, since the income-producing element of the lease is the original leasehold.

Problems of the lessee's successor are actually the same as those of the lessee himself, since the lessee's successor will stand in the same position as the lessee, with no different position afforded him when he takes by inheritance, assignment, or sublease. The unique situation of the *Millinery Center* case does offer one advantage to the lessee, however, when he succeeds himself by purchase of the fee after he has leased it, built, and depreciated improvements. Here the lessee-purchaser gains the distinct advantage of being able to depreciate his own improvements twice — once as builder-lessee, and again as purchaser-investor. The second depreciable basis is gained by a capital outlay, thus the situation is no more anomalous than that of a subsequent purchaser of fully depreciated property depreciating his investment. The supposed anomaly springs only from the theoretical nature of "estimated life" concepts, and their occasional departure from reality.

These areas of uncertainty must be carefully watched by attorneys concerned with the drafting of business leases, since the uncertainty itself indicates possible changes in the area. But as regards the status of the lessee's improvements, rental or non-rental, as income to the lessor, the law is apparently stable, having run the gamut of critical appraisal since *Miller v. Gearin* in 1916. In general, it forms a fairly sound foundation upon which to successfully predict the legal effects of a carefully drawn lease.

Paul B. Coffey