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Private Letter Ruling 9110001

August 2, 1990

ISSUE

May X allocate its cost basis of land and buildings according to the assessed values of the land and buildings for real estate tax purposes?

FACTS

On b, X purchased the fee simple interest of c and d for a total purchase price of e. On f, the Merger Warranty Deed was recorded as g at the h. The property is improved with a six story plus seventh story penthouse elevated structure which was formerly a 100-room hotel and a two-story walk up structure that was formerly a 16-unit motel. Since i, the two structures have been substantially altered for j. Other site improvements include an on-site parking lot, landscaping, and concrete walks and pads. The zoning of the building is k. The engineer for the Internal Revenue Service is of the opinion that the Highest and Best Use of the site is its use in l, which was for a combination m. This use meets the criterion of the k zoning for the site.

X allocated the total purchase price of e between the land and buildings based on the assessed values of X's land and buildings for real estate tax purposes. The revenue agent, however, believes that the engineer's report reflects the fair market value of the land and buildings and proposes to allocate X's purchase price according to that ratio.

LAW

Under *section 1012 of the Internal Revenue Code*, the basis of property will generally be the cost of such property, except as otherwise provided in this subchapter O and subchapters C (relating to corporate distributions and adjustments), K (relating to partners and partnerships), and P (relating to capital gains and losses).

Section 167(a) of the Code provides that there will be allowed as a depreciation deduction a reasonable allowance for the exhaustion, wear, and tear (including a reasonable allowance for obsolescence) (1) of property used in the trade or business, or (2) of property held for the production of income. Section 1.167(a)-5 of the Income Tax Regulations provides that in the case of the acquisition on or after March 1, 1913, of a combination of depreciable and nondepreciable property for a lump sum, as for example, buildings and land, the basis for depreciation cannot exceed an amount which bears the same proportion to the lump sum as the value of the depreciable property at the time of acquisition bears to the value of the entire property at that time.

RATIONALE

Under section 1.167(a)-5 of the regulations, when multiple properties are acquired simultaneously, the purchase price must be allocated among the individual properties acquired

according to their value. See also *Fairfield Plaza, Inc. v. Commissioner*, 39 T.C. 706, 711-712 (1963), acq., 1963-2 C.B. 4. The value of properties is a factual determination. Moreover, the government is not bound by the allocation of values made in a purchase contract and may determine if the allocation has meaningful substance. See *Palo Alto Town & Country Village, Inc. v. Commissioner*, 565 F.2d 1388 (9th Cir. 1977), aff'g, T.C. Memo 1973-223; Rev. Rul. 69-539, 1969-2 C.B. 141. Accordingly, the government is not bound by a taxpayer's allocation of values and may re-examine the allocation.

X argues that its purchase price for the land and buildings may be allocated based on the assessed values of X's land and buildings for real estate tax purposes. X notes that the United States Tax Court has recognized allocations of purchase price based on the ratio of real property tax assessment valuations of land and buildings. See 2554-58 *Creston Corp. v. Commissioner*, 40 T.C. 932, 939-940 (1963); *Maloney v. Commissioner*, T.C. Memo 1975-286. X also notes that the Internal Revenue Service has recommended on occasion to allocate purchase price on this same basis. See *Smith v. Commissioner*, 51 T.C. 429, 441 (1968); *Parker Tree Farms, Inc. v. Commissioner*, T.C. Memo 1983-357; *Dennert v. Commissioner*, T.C. Memo 1964-5. Finally, X relies upon the following statement in Internal Revenue Publication 551, Basis of Assets, Rev. November 1988, page 3:

When you allocate your cost between land and buildings, the part of the cost that is used and the basis of each asset is the ratio of the fair market value of that asset to the fair market value of the whole property at the time you get it. If you are not certain of the fair market values of land and buildings, you may allocate the cost among them based on their assessed values for real estate tax purposes. (Emphasis added.)

X's citation of case law illustrates the statement contained in Publication 551 -- allocation of cost may be based on the assessed values of the properties for real estate tax purposes unless the fair market values of the properties is determinable. In all but one of these cases, the Tax Court used the assessed values of the properties to allocate the purchase price among the assets acquired. In some cases the government relied upon the assessed values of the properties to allocate the purchase price without offering any other evidence. See *Parker Tree Farms*; *Dennert*. In those cases, the taxpayer failed to meet the burden of proving the fair market values of the properties. In the other cases, both the government and the taxpayer offered evidence concerning the fair market values of the purchased assets. In *Maloney*, for example, the Tax Court was not persuaded by either party's evidence and allocated the purchase price based on the assessed values of the assets. In *Smith*, however, the Tax Court found the government expert's use of the assessed values to be consistent with the fair market values of the properties. The government's expert took into account several methods of valuation in reaching its conclusion. Finally, in 2554-58 *Creston Corp.*, the government offered evidence that the assessed values of the purchased assets closely represented their fair market values. The Tax Court, nonetheless, found the fair market values of the properties to be less than their assessed values.

Accordingly, the examining agent may re-examine X's allocation of purchase price between the land and buildings. As the Tax Court noted in footnote five in 2554-58 *Creston Corp.*, the assessed values of properties may be used "in determining the relative value" of properties. The assessed values, however, may alone be used to allocate the purchase price only if other evidence does not exist to determine the fair market values of the properties. If the examining agent determines from other evidence that X's allocation does not reflect the fair market values of the properties, then the examining agent may re-allocate the purchase price based on the facts. X must bear the burden of proving that the examining agent's allocation is incorrect.

CONCLUSION

X may not allocate its cost basis of land and buildings solely according to the assessed values of the land and buildings for real estate tax purposes when better evidence exists to determine the fair market values of the properties.

A copy of the technical advice memorandum is to be given to the taxpayer. *Section 6110(j)(3) of the Code* provides that it may not be used or cited as precedent.