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Hazard v. Commissioner

7 T.C. 372 (1946)

This proceeding involves a deficiency in income tax for the calendar year 1943 in the amount of \$4,467.24. The only issue submitted is whether a loss sustained upon the sale of improved real estate, formerly occupied by petitioner as a residence, is deductible in full as an ordinary loss or as a long term capital loss. The case was submitted upon a stipulation of facts, oral testimony, and exhibits. The stipulated facts are so found. Other facts are found from the record.

FINDINGS OF FACT.

Petitioner is an individual, residing at 5023 Frew Street, Pittsburgh, Pennsylvania. The return for the period involved was prepared on the cash basis and filed with the collector of internal revenue for the twenty-third district of Pennsylvania. Prior to 1938 petitioner engaged in the general practice of law at Kansas City, Missouri. Effective in October 1938, petitioner was employed as general counsel for the Pittsburgh Plate Glass Co., which employment required him to maintain his office and post of duty at Pittsburgh. Prior to 1940 petitioner severed his law partnerships in Kansas City, and he has since devoted his entire time to the Pittsburgh Plate Glass Co., for which he received a salary of \$50,000 in 1943.

In 1930 petitioner purchased a residence at No. 1005 Brentwood Circle, Kansas City, Missouri, at a cost of \$27,000, allocated on a basis of \$6,000 for the land and \$21,000 for the improvements. Subsequently he made additional improvements, aggregating \$5,600, so that his total original cost was \$32,600. Petitioner and his family occupied such residence until July 1, 1939, when they moved to Pittsburgh. In February 1940, petitioner purchased stock in a cooperative apartment building in Pittsburgh, entitling him to an apartment therein, which he and his family have occupied since the purchase. Prior to 1943 petitioner registered and voted in Allegheny County, Pennsylvania. On March 18, 1940, he was duly admitted to practice before the Supreme Court of Pennsylvania. On or about January 1, 1940, petitioner listed his Kansas City home with real estate agents for rent or for sale. Early in 1940 said property was rented at \$75 per month. The property was continuously rented until sold on November 1, 1943. The depreciation on the building and the additions, from the date of acquisition to January 1, 1940, based on an estimated life of 33 $\frac{1}{3}$ years from the acquisition date, is as follows:

\$21,000 at 28 1/2% _____	\$5,985.00
1,000 at 19 1/2% _____	195.00
600 at 10 1/2% _____	63.00
3,000 at 4 1/2% _____	135.00

Total _____	6,378.00

The depreciated value at January 1, 1940, was \$25,222, allocated on a basis of \$6,000 to the land and \$19,222 to the improvements. The fair [pg. 374] market value of the properties on January 1, 1940, was equal to the depreciated value.

During the time the property was rented it continued to be listed for sale. In his Federal income tax returns for the years 1941, 1942, and 1943 petitioner claimed and was allowed depreciation on the buildings. The rate of 2 per cent per annum was claimed in petitioner's return for 1943. For the period January 1, 1940, to the date of sale on November 1, 1943, \$1,819.38 in depreciation was claimed and allowed.

The sale price of the properties in question was \$18,500, on which petitioner claimed a net loss of \$6,844.92, computed as follows:

Fair market value on January 1, 1940	_____	\$25,222.00
Less: Depreciation on \$19,222, value of dwelling for period Jan. 1, 1940, to Nov. 1, 1943, on estimated life of 40 1/2 years	_____	1,819.38

Adjusted value of property Nov. 1, 1943	_____	23,402.62
Sale price of property	_____	\$18,500.00
Less furniture, carpets, tools and equipment	_____	1,000.00

		17,500.00
Less cost of sale	_____	942.36
	-----	\$16,557.70

Net loss from sale	_____	6,844.92

The respondent determined the loss sustained is allowable as a long term capital loss to the extent of \$1,000, computed as follows:

Net loss from sale	_____	\$6,844.92
Loss taken into account	_____	3,422.46
Limitation of capital loss under		

sec. 117 (d) (2), I. R. C. _____ 1,000.00

Capital loss carry-over _____ 2,422.46

OPINION.

Leech, Judge:

The sole question presented is the extent the loss of \$6,844.92 sustained by the petitioner, an attorney at law, on the sale of his former residence in Kansas City, is deductible for income tax purposes. Petitioner contends that the total net loss is deductible under section 23 (e) (1) of the Internal Revenue Code as a "

*** [loss] sustained during the taxable year and not compensated for by insurance or otherwise

*** ." The respondent determined the property in question was a capital asset, on the ground that it was not used in petitioner's trade or business, and therefore restricted the deductible loss on its sale in accordance with the limitations provided in section 117 of the code, as amended by the Revenue Act of 1942. Prior to the Revenue Act of 1942 the established rule followed by this and other courts over a long period was [pg. 375]that residential improvements on real estate converted into income-producing property are property "used in the trade or business of the taxpayer," regardless of whether or not he engaged in any other trade or business, and are therefore excluded from the definition of "capital assets" as defined by section 117 (a) (1). John D. Fackler, 45 B. T. A. 708 (and cases therein cited); affd., 133 Fed. (2d) 509; N. Stuart Campbell, 5 T. C. 272; George S. Jephson, 37 B. T. A. 1117. The undisputed facts bring the instant case within that rule. Thus, unless the amendments contained in the Revenue Act of 1942 require a change in the rule, the petitioner's position must be upheld.

While the Revenue Act of 1942 amended section 117 in several respects, those here material are contained in section 151 (a) and (b) of the act, 1 made applicable by section 101 to taxable years beginning after December 31, 1941. Section 151 (a) excludes from the definition of capital assets "real property used in the trade or business of the taxpayer." The purpose of this amendment was to obviate the difficulty of allocating the capital gains and losses between the land and buildings; the land therefore having been treated as a capital asset and the improvements as noncapital assets. 2 We find nothing [pg. 376]in this amendment indicative of an intent by the Congress to change the rule established by the Fackler case, supra. Section 151 (b) of the 1942 Act added the new subsection (j), covering, as its title indicates, "Gains and Losses From Involuntary Conversions and From the Sale or Exchange of Certain Property Used in the Trade or Business." This section provides for special treatment where gains exceed losses from involuntary conversions and from the sale of certain property used in a trade or business. Such gains are treated as capital gains. This is a relief provision for the benefit of such taxpayers as come within its provisions. 3 Losses in excess of gains in respect to such property are still treated as ordinary losses allowable in full. We, therefore, find nothing in subsection (j), or any other amendment contained in the 1942 Act, which indicates to us that Congress intended that real estate such as here involved, which at the time of its sale was devoted to producing income, and on which depreciation was allowed under section 23 (l), should be treated as a capital asset, except under

the special circumstances contained in section (117) (j), which are not present in the instant case. The respondent refers us to a portion of Regulations 111, section 29.117-1, which provides:

*** Property held for the production of income, but not used in a trade or business of the taxpayer, is not excluded from the term "capital assets" even though depreciation may have been allowed with respect to such property under section 23 (l) prior to its amendment by the Revenue Act of 1942.

The property here, however, was "used in the trade or business of the taxpayer." The quoted regulation, by its terms, specifically excludes such from its purview. We conclude that petitioner's Kansas City real estate, formerly occupied as his residence, was not a "capital asset" at the time of its sale. 4 Petitioner is, therefore, entitled to a deduction for the total net loss of \$6,844.92, as an ordinary loss under section 23 (e) of the Internal Revenue Code.

The petition also assigns as error the disallowance as a deduction of the sum of \$185 paid to the Duquesne Club of Pittsburgh for membership dues. No evidence was offered and petitioner's brief does not discuss that issue. It is deemed abandoned and the respondent's disallowance of said amount is sustained.

Reviewed by the Court.

Decision will be entered under Rule 50.

Disney and Opper, JJ., did not participate in the consideration of or decision in this report.

1 SEC. 151. REAL PROPERTY; INVOLUNTARY CONVERSION; ETC.

(a) Real Property Not Treated as Capital Asset.-Section 117 (a) (1) (relating to the definition of "capital assets") is amended by inserting immediately before the semicolon at the end thereof a comma and the following: "or real property used in the trade or business of the taxpayer".

(b) Gains and Losses From Involuntary Conversion and From the Sale or Exchange of Certain Property Used in the Trade or Business.-Section 117 (relating to capital gains and losses) is amended by inserting at the end thereof the following new subsection:

"(j) Gains and Losses From Involuntary Conversion and From the Sale or Exchange of Certain Property Used in the Trade or Business.-

(1) "Definition of Property Used in the Trade or Business.-For the purposes of this subsection, the term 'property used in the trade or business' means property used in the trade or

business, of a character which is subject to the allowance for depreciation provided in section 23 (1), held for more than 6 months, and real property used in the trade or business, held for more than 6 months, which is not (A) property of a kind which would properly be includible in the inventory of the taxpayer if on hand at the close of the taxable year, or (B) property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business.

(2) "General Rule.-If, during the taxable year, the recognized gains upon sales or exchanges of property used in the trade or business, plus the recognized gains from the compulsory or involuntary conversion (as a result of destruction in whole or in part, theft or seizure or an exercise of the power of requisition or condemnation or the threat or imminence thereof) of property used in the trade or business and capital assets held for more than 6 months into other property or money, exceed the recognized losses from such sales, exchanges, and conversions, such gains and losses shall be considered as gains and losses from sales or exchanges of capital assets held for more than 6 months. If such gains do not exceed such losses, such gains and losses shall not be considered as gains and losses from sales or exchanges of capital assets. For the purposes of this paragraph:

(A) "In determining under this paragraph whether gains exceed losses, the gains and losses described therein shall be included only if and to the extent taken into account in computing net income, except that subsections (b) and (d) shall not apply.

(B) "Losses upon the destruction, in whole or in part, theft or seizure, or requisition or condemnation of property used in the trade or business or capital assets held for more than 6 months shall be considered losses from a compulsory or involuntary conversion."

2 H. Rept. No. 2333, 77th Cong., 1st sess., on Revenue Act of 1942.

3 S. Rept. No. 1631, 77th Cong., 2d sess.; H. Rept. No. 2586, 77th Cong., 2d sess. (conference report).

4 See Harvard Law Review, Nov. 1945, p. 119.