5 T.C. 272 (1945)

A loss incurred from the sale of property inherited and immediately listed for sale or rent is deductible as a loss in a transaction entered into for profit, and the portion of the loss attributable to the sale of the building is considered an ordinary loss, not a capital loss, if the property was never used in the taxpayer's trade or business.

Summary

N. Stuart Campbell inherited a one-half interest in a house and land from his father. Campbell never resided in the inherited property and immediately listed it for sale or rent. When the property was eventually sold at a loss, Campbell sought to deduct the loss. The Commissioner of Internal Revenue disallowed the deduction, arguing it was not a transaction entered into for profit and should be treated as a capital loss. The Tax Court held that the loss was deductible as it was a transaction entered into for profit, and the portion of the loss from the sale of the building was an ordinary loss.

Facts

N. Stuart Campbell inherited a one-half interest in a house and land in Providence, Rhode Island, from his father in 1934. The father had used the property as his personal residence. Campbell, who resided in Massachusetts, never intended to use the inherited property as his residence. Immediately after inheriting the property, Campbell listed it for sale or rent with real estate agents. Campbell and his sister (who inherited the other half) considered remodeling the property into apartments but were prevented by zoning laws. The property was finally sold in 1941, resulting in a loss.

Procedural History

The Commissioner of Internal Revenue determined a deficiency in Campbell's income tax for 1941, disallowing a net long-term loss and an ordinary loss from the sale of the inherited property. Campbell petitioned the Tax Court for a redetermination of the deficiency.

Issue(s)

1. Whether the loss suffered by the taxpayer upon the sale of the house and land which he inherited from his father is deductible under Section 23(e) of the Internal Revenue Code as a loss incurred in a transaction entered into for profit.

2. Whether the loss suffered by the taxpayer upon the sale of the house, as distinguished from the land, is an ordinary loss deductible in full, or a capital loss subject to limitations under Section 117 of the Internal Revenue Code.

Holding

1. Yes, because the taxpayer immediately listed the inherited property for sale or rent, demonstrating an intent to enter into a transaction for profit.

2. The loss attributable to the sale of the house is an ordinary loss deductible in full, because the house was not used in the taxpayer's trade or business.

Court's Reasoning

The court distinguished cases where taxpayers converted their personal residences into properties for sale or rent. In those cases, merely listing the property was insufficient to demonstrate a transaction entered into for profit. Here, Campbell never used the property as a personal residence and immediately sought to sell or rent it. The court stated, "The fact that property is acquired by inheritance is, by itself, neutral." The critical inquiry is how the property was used after inheritance. Because Campbell immediately listed the property, he demonstrated an intent to derive a profit. Regarding the characterization of the loss on the house, the court relied on 26 U.S.C. § 117(a)(1), which excludes depreciable property used in a trade or business from the definition of a capital asset. The court reasoned that because Campbell never used the house in his trade or business, the loss from its sale was an ordinary loss, citing *George S. Jephson, 37 B.T.A. 1117*, and *John D. Fackler, 45 B.T.A. 708*.

Practical Implications

This case clarifies the tax treatment of losses incurred on inherited property. It establishes that inheriting property previously used as a personal residence does not automatically preclude a loss on its sale from being treated as a deductible loss incurred in a transaction for profit. The taxpayer's intent and actions following the inheritance are critical. Immediate efforts to sell or rent the property are strong evidence of intent to generate a profit. Furthermore, the case reinforces that losses on depreciable property are considered ordinary losses if the property was not used in the taxpayer's trade or business. This distinction is essential for determining the extent to which a loss can be deducted in a given tax year. Later cases would distinguish the facts where the taxpayer had lived in the property for some time before listing it for sale.

