5 T.C. 964 (1945)

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When a building is demolished to make way for a new structure, the undepreciated cost (adjusted basis) of the demolished building can be included in the depreciation basis of the new building, even if there was no original intent to demolish when the property was acquired.

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Summary

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Henry Phipps Estates demolished several buildings to construct new ones and sought to include the adjusted basis of the demolished buildings in the depreciation basis of the new buildings. The IRS disallowed this, arguing that since there was no intent to demolish at the time of purchase, the loss should have been claimed in the year of demolition. The Tax Court, however, held that the adjusted basis of the old buildings could be included in the depreciation basis of the new buildings, relying on *Commissioner v. Appleby*. This ruling allows taxpayers to treat the demolition cost as part of the new asset's cost, depreciated over its life, even if the intent to demolish arose after the initial acquisition.

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Facts

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The petitioner, Henry Phipps Estates, purchased land and buildings at various locations in New York City between 1908 and 1923.

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Over time, the petitioner demolished the existing buildings on these sites to erect new structures.

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The petitioner did not claim any deductions for the demolition of the old buildings in the years they were demolished.

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In its 1939 tax return, the petitioner sought to include the adjusted basis of the demolished buildings in the depreciation basis of the new buildings.

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Procedural History

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The Commissioner of Internal Revenue disallowed the inclusion of the adjusted basis of the demolished buildings in the depreciation basis of the new buildings, resulting in a tax deficiency.

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The petitioner appealed the Commissioner’s decision to the United States Tax Court.

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Issue(s)

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Whether the adjusted basis of buildings demolished to make way for new structures can be included in the depreciation basis of the new buildings, even if there was no intent to demolish the old buildings at the time the property was acquired.

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Holding

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Yes, because when the purpose of demolition is to make way for the erection of a new structure, the result is merely to substitute a more valuable asset for the less valuable, and the loss from demolition may reasonably be considered as part of the cost of the new asset and depreciated during its life.

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Court’s Reasoning

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The Tax Court relied on the precedent set in *Commissioner v. Appleby*, which held that the adjusted basis of a demolished building could be included in the depreciation basis of a new building erected on the same site. The court emphasized that the key factor is whether the demolition was intended to make way for a new structure. If so, the demolition cost should be treated as part of the new asset's cost.

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The court distinguished this situation from cases where a building is demolished because it is unsuitable for further use, in which case a loss deduction is allowed in the year of demolition.

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The court quoted *Young v. Commissioner*, stating that the rule denying a loss when there is intent to raze and replace buildings at the time of acquisition does not exclude cases where the taxpayer did not have that intent at the time of purchase.

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The court also distinguished *Union Bed & Spring Co. v. Commissioner*, where a business loss was allowed due to unexpected repairs, from cases where an owner merely substitutes one building for another on property already owned.

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The court stated,

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