N. W. Ayer & Son, Inc. v. Commissioner, 17 T.C. 631 (1951)

When a taxpayer demolishes a building to erect a new structure, the adjusted basis of the demolished building, less any salvage, can be included in the depreciable basis of the new building, regardless of whether there was an intent to demolish at the time of purchase.

Summary

N. W. Ayer & Son, Inc. sought to include the adjusted basis of demolished buildings in the depreciation basis of new buildings erected on the same site. The Commissioner denied this, arguing that no intent to demolish existed at the time of purchase. The Tax Court held that the intent at the time of purchase was irrelevant. When a building is demolished to make way for a new structure, the remaining basis of the old building becomes part of the cost of the new asset and is depreciated over its life, regardless of the initial intent. This decision allows taxpayers to recoup the undepreciated cost of demolished buildings through depreciation of the new structure.

Facts

N. W. Ayer & Son, Inc. owned property with existing buildings. At some point after acquiring the property, the company decided to demolish the existing buildings and construct new ones. The taxpayer then sought to include the adjusted basis of the demolished buildings (less salvage value) in the depreciation basis of the new buildings.

Procedural History

The Commissioner of Internal Revenue disallowed the inclusion of the demolished buildings' basis in the depreciation calculation for the new buildings. N. W. Ayer & Son, Inc. appealed to the Tax Court of the United States.

Issue(s)

Whether the adjusted basis of demolished buildings can be included in the depreciable basis of a new building erected on the same site when there was no intent to demolish the old buildings at the time of purchase.

Holding

Yes, because when the purpose of demolition is to make way for the erection of a new structure, the remaining basis of the demolished building can be considered part of the cost of the new asset and depreciated during its life, regardless of the initial intent at the time of purchase.

Court's Reasoning

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The Tax Court relied on prior case law, particularly *Commissioner v. Appleby*, 123 F.2d 700 (2d Cir. 1941), which held that the intent to raze and rebuild at the time of purchase is not the sole determinant of whether the basis of the demolished building can be included in the new building's depreciation basis. The court quoted *Appleby*: "If a building is demolished because unsuitable for further use, the transaction with respect to the building is closed and the taxpayer may take his loss; but if 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 to be depreciated during its life." The court emphasized that the critical factor is whether the demolition is part of a plan to replace the old structure with a new one. The court distinguished cases where a loss was allowed due to unexpected repairs or changes because, in those cases, there was a true business loss suffered. Here, the taxpayer merely substituted one building for another on property already owned, making it a capital improvement rather than a deductible loss. The court specifically noted that the rebuilding, and not merely the demolition, is the crucial element.

Practical Implications

This case provides taxpayers with a clear path to recoup the remaining basis of demolished buildings. It clarifies that the taxpayer's intent at the time of purchase is not the deciding factor. What matters is that the demolition is undertaken to facilitate the construction of a new building. This decision is important for real estate developers and businesses that redevelop existing properties. Legal practitioners should advise clients that the adjusted basis of a demolished building can be added to the cost basis of a new building for depreciation purposes, even if the decision to demolish and rebuild was made after the initial acquisition. This allows for a more accurate reflection of the true cost of the new asset and provides a tax benefit through increased depreciation deductions. This ruling has been followed in numerous subsequent cases when determining the proper tax treatment of demolished structures.

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