6 T.C. 799 (1946)

A taxpayer's deduction for the demolition of buildings is limited to the unexhausted basis of the buildings, and expenses incurred during tax controversies are deductible as non-business expenses.

Summary

The Tax Court addressed whether taxpayers William and Lydia Heyman could deduct a loss sustained from demolishing buildings and legal/accounting fees paid during a tax dispute. The court held that the demolition loss was limited to the unexhausted basis of the buildings, not their asserted value. It also allowed the deduction for expenses related to the tax controversy, aligning with precedent that such expenses are deductible. This case clarifies the calculation of demolition loss deductions and reaffirms the deductibility of certain tax-related expenses.

Facts

Lydia Heyman acquired property known as Scandia Gardens through foreclosure in 1937, paying $24,327.88 for mortgages and $2,337.36 in back taxes. The property included various buildings, some unoccupied before the acquisition. In December 1941, Heyman demolished six buildings to reduce taxes, receiving no cash as the wreckers took the salvage for compensation. The taxpayers also paid $625 in accounting fees in 1941 related to disputes with the IRS and the New York State Tax Commission.

Procedural History

The Commissioner of Internal Revenue determined a deficiency in the Heymans' 1941 income tax. The Heymans petitioned the Tax Court, contesting the disallowance of a $17,500 deduction for the demolition loss and a $625 deduction for legal and accounting fees. The Tax Court partially sided with the Heymans, adjusting the demolition loss and allowing the deduction for the accounting fees.

Issue(s)

1. Whether the taxpayers can deduct $17,500 as a loss sustained upon the demolition of six buildings, based on their asserted value at the time of demolition.
2. Whether the taxpayers are entitled to deduct $625 paid for accounting services related to tax controversies.

Holding

1. No, because the deduction for a loss is limited to the adjusted basis for gain or loss, as provided in sections 23(e)(1) or (2) and 113(a) and (b) of the Internal Revenue Code.
2. Yes, because expenses paid for services related to tax controversies are

deductible under section 23(a)(2) of the Internal Revenue Code as non-trade or non-business expenses for the management, conservation, or maintenance of property held for the production of income.

Court's Reasoning

Regarding the demolition loss, the court rejected the taxpayers' reliance on *Union Bed & Spring Co. v. Commissioner*, emphasizing that a deduction for loss is limited to the adjusted basis of the demolished property, not its current value. The court found the unexhausted basis for the demolished buildings to be $6,889, and adjusted the Commissioner's allowance accordingly. The court stated, "A deduction for loss under section 23 (e) (1) or (2) is limited to the adjusted basis for gain or loss provided in section 113 (a) and (b)."

On the deductibility of the accounting fees, the court followed *Herbert Marshall* and *Bingham Trust v. Commissioner*, holding that expenses for consultations and conferences with tax authorities are deductible under section 23(a)(2) as ordinary and necessary expenses for the management, conservation, or maintenance of property held for the production of income.

Judge Disney dissented on the accounting fee issue, arguing that the facts presented were insufficient to justify the deduction. He emphasized the lack of a proximate connection between the accounting services and the production or collection of income or the management of income-producing property.

Practical Implications

This case clarifies the tax treatment of demolition losses, emphasizing that taxpayers cannot deduct the fair market value of demolished property if it exceeds the adjusted basis. It underscores the importance of accurately determining the basis of assets for depreciation and loss calculations. The decision also confirms the deductibility of expenses incurred in tax controversies, provided they relate to the management or conservation of income-producing property. Later cases and IRS guidance continue to refine the definition of deductible tax-related expenses, often focusing on whether the expenses are directly connected to business or investment activities rather than personal matters. Attorneys and accountants should advise clients to maintain thorough records to support their basis calculations and the nexus between tax-related expenses and income-producing activities.

