7 T.C. 980 (1946)

A taxpayer who inherits property, including a building erected by a lessee, is entitled to a depreciation deduction based on the fair market value of the building at the date of the decedent's death, even if the property is subject to a long-term lease.

Summary

Catherine Currier inherited a beneficial interest in a trust that included an 11-story building erected by a lessee under a 75-year lease. The IRS denied her depreciation deduction, arguing the building cost the lessor nothing. The Tax Court held that Currier was entitled to a depreciation deduction based on the building's fair market value at her father's death. The court reasoned that inheritance triggers estate tax, establishing a basis for depreciation, and the tenant's obligation to return the property in good repair did not negate the inevitable depreciation of the building.

Facts

William O. Blake leased land to George Carpenter, who erected an 11-story building (the Blake Building) per the lease terms. The lease, dated 1904, ran for 75 years from August 1, 1908. Blake died in 1934, leaving the residue of his estate, including the leased property, in trust for his wife and daughters, including Catherine Currier. The lease required the lessee to maintain the building and return it in first-class condition at the lease's end. Currier claimed a depreciation deduction based on her share of the building's value but the IRS disallowed it.

Procedural History

Currier filed a joint tax return with her husband, claiming a depreciation deduction related to her interest in the Blake Building. The Commissioner of Internal Revenue disallowed the deduction, leading Currier to petition the Tax Court. The Tax Court reviewed the Commissioner's decision.

Issue(s)

Whether a taxpayer who inherits property subject to a long-term lease, where the lessee constructed the building, is entitled to a depreciation deduction based on the fair market value of the building at the date of the decedent's death.

Holding

Yes, because the inheritance triggers estate tax, which establishes a basis for depreciation, and the lessee's obligation to maintain the property does not negate the inherent depreciation of an aging building.

Court's Reasoning

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The Tax Court distinguished this case from situations where a lessor attempts to claim depreciation on improvements made by a lessee, where the lessor has no cost basis. Here, the inheritance of the property triggered estate tax, establishing a fair market value basis for depreciation under Internal Revenue Code Section 113(a)(5). The court emphasized that the basis of inherited property is fair market value at the time of acquisition, not cost. The court also addressed the argument that the lessee's obligation to return the building in good repair negated any depreciation. The court reasoned that even with good maintenance, a 50-year-old building would inevitably depreciate, and the lease did not require the lessee to replace the building with a new one. "If this imports an obligation to 'return to it [the lessor] replaced buildings equal to the value of the property originally leased,' it eliminates the prospect of loss and with it the depreciation deductions." Since the lease only required returning the same building in good repair, the court concluded that Currier would suffer a loss from depreciation and was entitled to a deduction.

Practical Implications

This case clarifies that inherited property, even when subject to a lease where the lessee erected the improvements, is eligible for depreciation deductions based on its fair market value at the time of inheritance. This is especially relevant for estate planning and tax strategies involving real estate. Attorneys should advise clients inheriting leased property to obtain a professional appraisal to determine the fair market value at the date of death to maximize potential depreciation deductions. It highlights the importance of carefully examining lease terms to determine the scope of a lessee's obligation to maintain and return property, as this can affect the depreciation deduction. Later cases applying this ruling would likely focus on establishing fair market value and interpreting lease provisions related to property maintenance and return.

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