9 T.C. 756 (1947)

A taxpayer can deduct a loss on the sale of property inherited from a parent, even if the taxpayer resided on the property as a minor, if, upon reaching adulthood and gaining control of the property, the taxpayer attempts to rent or sell it rather than using it for personal purposes.

Summary

George Carnrick inherited property from his mother, which was held in trust until he turned 21. After the trust terminated, Carnrick tried to rent or sell the property. He later sold the property for less than its value at the time of his mother's death and sought to deduct the loss. The Tax Court held that Carnrick was entitled to deduct the loss as an ordinary loss on the building and a capital loss on the land. The court reasoned that Carnrick's intent upon gaining control of the property, rather than his prior residency as a minor, determined its character for tax purposes.

Facts

Katherine Carnrick died in 1933, leaving her estate in trust for her two children, Alice and George (the petitioner). The trust was to terminate when George reached 21. Included in the trust was a residence where Katherine lived until her death. The trustees allowed George and Alice to live in the house and collected rent from their guardian. Alice died in 1937, and George moved out in 1938. Upon reaching majority in 1939, George inherited the property and actively tried to rent or sell it, but was unsuccessful. He sold the property in 1941 for significantly less than its value at the time of his mother's death.

Procedural History

The Commissioner of Internal Revenue determined a deficiency in Carnrick's 1941 income tax. Carnrick contested the deficiency, claiming he was entitled to deduct the loss from the sale of the inherited property. The Tax Court addressed whether the deficiency notice was timely and whether Carnrick sustained deductible losses.

Issue(s)

1. Whether the notice of deficiency was timely mailed to the petitioner.

2. Whether the petitioner sustained deductible losses upon the sale of the inherited real property in the taxable year.

Holding

1. Yes, because under Section 3804 of the Internal Revenue Code, the statute of limitations was tolled while the petitioner was outside the Americas during his military service.

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2. Yes, because upon gaining control of the inherited property, the petitioner intended to use it for income-producing purposes (rent or sale), thus entitling him to deduct the loss incurred upon its sale.

Court's Reasoning

The court determined the deficiency notice was timely under Section 3804 of the Internal Revenue Code, which extended the statute of limitations due to the petitioner's military service overseas. Regarding the loss deduction, the court distinguished the case from situations where the taxpayer had previously used the property for personal purposes. The court emphasized that the petitioner's intent upon inheriting the property was to rent or sell it for profit. The court reasoned that because the property was held in trust during Carnrick's minority, he had no control over its use until he reached 21. The court stated, "It is thus apparent that the earliest point in time that the petitioner had any power to determine to what use the property should be put was the day he attained his majority…His decision was to put it to productive rather than to a personal use." Therefore, the loss was deductible. The court relied on *Estelle G. Marx, 5 T.C. 173*, and *N. Stuart Campbell, 5 T.C. 272*, noting that inheriting property is neutral, and the taxpayer's actions after inheritance determine whether a loss is deductible. The court distinguished *Leland Hazard, 7 T.C. 372*, and held that the loss on the building was an ordinary loss, while the loss on the land was a capital loss, based on the law in effect at the time of the sale.

Practical Implications

This case clarifies that the intent behind holding inherited property at the time the taxpayer gains control is critical in determining whether a loss on its sale is deductible. It provides a taxpayer-friendly interpretation in situations where inherited property was previously used as a residence but is later intended for income-producing activities. The case emphasizes that prior personal use by someone other than the taxpayer, especially when the taxpayer is a minor and the property is held in trust, does not necessarily preclude a loss deduction. Subsequent cases should focus on the taxpayer's actions and intentions immediately following inheritance to determine if the property was truly converted to an income-producing purpose. This case highlights the importance of documenting efforts to rent or sell the property to demonstrate intent.

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