9 T.C. 862 (1947)

For tax purposes, separately acquired properties are generally treated as distinct units when sold, unless they have been substantially integrated into a single economic unit.

Summary

William Krahl sold two adjacent properties to a corporation he controlled. The properties, acquired separately in 1920 and 1926, had separate buildings and were accounted for separately on Krahl's books for depreciation. Krahl argued the sale was of a single property, resulting in no gain. The IRS determined the sale involved two properties, leading to a capital gain on one property and a disallowed loss on the other. The Tax Court sided with the IRS, holding that the properties remained distinct units despite their proximity and Krahl's intent to protect one property with the purchase of the other.

Facts

Krahl purchased a property at 109 W. Hubbard in 1920, improving it with a five-story building. In 1926, he bought an adjacent property at 420 N. Clark, improved with a three-story building. The rear of the Clark Street property was contiguous with the side of the Hubbard Street property. Krahl bought the Clark Street property to protect the Hubbard Street building from potential damage from new construction and to potentially replace both with a single building. The buildings had no internal connections, separate utilities, and were treated separately for local tax purposes. Krahl sold both properties in a single transaction to a company he controlled.

Procedural History

The Commissioner of Internal Revenue determined a deficiency in Krahl's income tax for 1943, arguing the sale involved two separate properties, resulting in a capital gain and a disallowed loss due to the related-party nature of the sale. Krahl petitioned the Tax Court, arguing the sale was of a single property. The Tax Court upheld the Commissioner's determination.

Issue(s)

Whether the sale of two adjacent properties, acquired at different times and treated separately for accounting and tax purposes, constitutes the sale of one property or two properties for federal income tax purposes.

Holding

No, because each property was acquired separately, had a separate cost basis and depreciation schedule, and was accounted for separately on Krahl's books. There was insufficient integration to treat them as a single economic unit.

Court's Reasoning

The court reasoned that generally, each purchase of property is a separate unit for determining gain or loss on a sale. The court emphasized the lack of substantial integration between the two properties. It noted the separate acquisition dates, cost bases, depreciation schedules, accounting treatment, local tax treatment, and utility metering. The court acknowledged that Krahl's purchase of the Clark Street property was partly to protect the Hubbard Street property, but found this insufficient to justify treating the sale as a single economic unit. The court cited *Lakeside Irrigation Co. v. Commissioner*, stating, "in ascertaining gain and loss by sales or exchanges of property previously purchased, in general each purchase is a separate unit as to which cost and sale price are to be compared." The court insisted on a "sufficiently thoroughgoing unification of separately purchased properties as naturally recommends a consolidation of their bases," which it found lacking in this case.

Practical Implications

This case clarifies that even adjacent properties with some interrelation will be treated as separate for tax purposes if they are acquired separately, accounted for separately, and lack substantial physical or economic integration. Taxpayers must maintain clear records for each property and should expect the IRS to treat them as separate units upon sale. The decision emphasizes the importance of demonstrating a "thoroughgoing unification" to justify consolidating the bases of separately purchased properties. Later cases distinguish *Krahl* by focusing on the degree of integration and interdependence of the properties in question. Attorneys advising clients on real estate transactions should carefully document the nature of each property, its use, and its relationship to any adjacent properties, to properly characterize the transaction for tax purposes.