11 T.C. 90 (1948)

A taxpayer may not deduct a loss from the sale of residential property unless it has been converted to an income-producing purpose prior to the sale, and the taxpayer must establish the property's adjusted basis at the time of conversion.

Summary

The Emmets sought to deduct a loss from the sale of their former residence after allowing the Red Cross and Bundles for Britain to use it rent-free. The Tax Court denied the deduction, holding that the Emmets did not convert the property to an income-producing purpose because the arrangement was primarily charitable and the "rent" was the abatement of taxes, which is not taxable income. Additionally, they failed to prove the property's fair market value or adjusted basis at the time of the purported conversion, preventing the calculation of a deductible loss. This case clarifies the requirements for converting personal property into property held for income production to claim a loss on its sale.

Facts

The Emmets owned a house in Erie, Pennsylvania, which they used as their personal residence until May 1940. They moved to a new residence and allowed the local chapter of the American Red Cross to occupy the property. In return, the Red Cross was to maintain the property and attempt to secure a reduction in local taxes. The Red Cross secured a partial tax abatement. Later, Bundles for Britain shared the occupancy and paid a portion of the maintenance expenses. The Red Cross vacated the property in late 1941, and Bundles for Britain left in October 1942. The Emmets sold the property in mid-November 1942 for $12,000 and claimed a loss on their tax return.

Procedural History

The Commissioner of Internal Revenue disallowed the loss deduction claimed by the Emmets. The Emmets petitioned the Tax Court for a redetermination of the deficiencies assessed by the Commissioner. The Tax Court consolidated the cases of Helen D. Emmet and H.L.R. Emmet.

Issue(s)

1. Whether the Emmets' residential property was appropriated to an income-producing purpose prior to its sale, allowing a loss deduction under Section 23(e)(1) of the Internal Revenue Code and Section 29.23(e)-1 of Regulations 111?

2. If so, whether the Emmets established the amount of the loss claimed from the sale of the property?

Holding

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1. No, because the Emmets' primary motive was charitable, and the tax abatement secured was not considered taxable income.

2. No, because the Emmets failed to establish the fair market value and adjusted basis of the property at the time it was purportedly converted to an income-producing purpose, which is necessary to calculate the deductible loss.

Court's Reasoning

The court reasoned that the Emmets' arrangement with the Red Cross and Bundles for Britain was primarily charitable, not income-producing. The court noted the absence of a formal rental agreement and the Emmets' active involvement in charitable work. The court stated,

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