12 T.C. 34 (1949)

Merely listing a former residence with a real estate broker, even exclusively, for rent, does not constitute appropriating the property to business use, and thus does not justify a deduction for any loss on a subsequent sale as a "transaction entered into for profit" under Internal Revenue Code, section 23(e)(2).

Summary

Allen and Malvina Grammer sought to deduct a loss on the sale of their former residence after moving to a new home and listing the old property for rent with real estate brokers. The Tax Court denied the deduction, holding that merely listing the property for rent, even exclusively, did not constitute an appropriation to business use or a transaction entered into for profit. The court emphasized that the taxpayers did not actually rent the property or otherwise use it for income-producing purposes before selling it. This case highlights the importance of demonstrating a clear intent to convert personal property into income-producing property to claim a loss deduction.

Facts

In 1930, Allen Grammer purchased land and constructed a residence in Meadowbrook, Pennsylvania, using it as his family's home until May 1942. In April 1938, Grammer began working in New York City, leading the family to purchase a new residence in Montclair, New Jersey, in the fall of 1941 and move there in May 1942. Upon moving, they took all their possessions and had no intention of returning to the Meadowbrook property. Grammer consulted with his lawyer, who advised listing the Meadowbrook property solely for rental to establish a business purpose. In June 1942, Grammer listed the property exclusively for rent with a real estate broker for six months, and later with another broker, but was unsuccessful in finding a tenant. In December 1943, Grammer engaged real estate agents for the sale of the property. The property was eventually sold in July 1944 for $40,000.

Procedural History

The Commissioner of Internal Revenue disallowed the loss deduction claimed by the Grammers on their 1944 income tax return related to the sale of the Meadowbrook property. The Grammers petitioned the Tax Court for a redetermination of the deficiency, arguing that the loss should be considered an ordinary loss because the property was converted to income-producing use before the sale.

Issue(s)

Whether the petitioners are entitled to a loss deduction on the sale of property which had previously been occupied by them as their residence and which had been offered for rental.

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Holding

No, because merely listing a former residence with a real estate broker for rent, even exclusively, does not constitute an appropriation to business use to justify a deduction for any loss on a subsequent sale as a “transaction entered into for profit” under Internal Revenue Code, section 23(e)(2).

Court’s Reasoning

The Tax Court reasoned that to deduct a loss on the sale of property originally acquired as a residence, the loss must be suffered in a “transaction entered into for profit.” The court stated that a mere listing with a broker, even exclusively, does not satisfy the statutory requirement or constitute an appropriation to income-producing purposes. The court cited relevant regulations and case law emphasizing that if the property has not been actually rented, its appropriation to income-producing purposes must be accompanied by a “use” for such purposes up to the time of its sale. The court determined that Grammer’s actions did not constitute an irrevocable position to an extent that he could not resume occupancy or sell the property. The court emphasized that all Grammer accomplished by the “exclusive” listing was to undertake that the property if rented would be rented through that broker or at least his commission would be paid, but there was no agreement as to the rental to be sought. Ultimately, the court concluded that Grammer’s actions fell short of constituting such a “transaction entered into for profit” as to place it out of his power to resume occupancy of the premises or to sell them.

Practical Implications

This case clarifies the requirements for converting personal property, such as a residence, into income-producing property for tax purposes. Taxpayers seeking to deduct a loss on the sale of a former residence must demonstrate more than merely listing the property for rent. Actual rental or other demonstrable use for income production is necessary to establish a “transaction entered into for profit.” Legal practitioners should advise clients to take concrete steps to convert property to business use, such as actively seeking tenants, making substantial improvements for rental purposes, and documenting these efforts, to support a potential loss deduction. This case is often cited in similar circumstances to deny loss deductions where taxpayers fail to demonstrate sufficient business use of a former residence before its sale. Subsequent cases have further refined the criteria for demonstrating conversion to income-producing use.

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