***Meredith v. Commissioner, 12 T.C. 344 (1949)***

Insurance proceeds received by a lessor for the destruction of improvements on leased property, where the lessor owns the improvements, are treated as capital gains from an involuntary conversion, not ordinary income related to lease termination.

**Summary**

Owen Meredith leased property to Petroleum Carrier Corporation, which constructed improvements that became Meredith's property per the lease agreement. The improvements were insured in Meredith's name. After the improvements were destroyed by fire, Meredith received insurance proceeds. The lessee then canceled the lease. The IRS argued the insurance proceeds were ordinary income because they were essentially consideration for the lease cancellation. The Tax Court held that the insurance proceeds were taxable as capital gains from an involuntary conversion, not ordinary income. This decision clarifies the tax treatment of insurance payouts when improvements on leased property are destroyed.

**Facts**

Owen Meredith leased land to Petroleum Carrier Corporation, requiring the lessee to construct improvements (warehouse, wharf, docks) costing at least $8,000.
The lease stipulated the improvements would become Meredith's property upon construction, subject to the lease terms.
The lessee was required to maintain fire insurance on the improvements, with policies in Meredith's name.
Improvements were completed in September 1941, and insured for $20,000.
The improvements were destroyed by fire on July 14, 1942, and Meredith received $19,132.77 in insurance proceeds.
The lessee decided not to rebuild and canceled the lease effective December 31, 1942.
Meredith refunded a portion of the rent and unearned insurance premiums to the lessee.

**Procedural History**

Meredith reported the insurance proceeds as a capital gain on his 1942 tax return.
The Commissioner of Internal Revenue determined the entire amount was taxable as ordinary income, resulting in a deficiency.
Meredith petitioned the Tax Court for review of the Commissioner's determination.

**Issue(s)**

Whether insurance proceeds received by a lessor, for the destruction of improvements on leased property owned by the lessor, should be taxed as ordinary

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income or as capital gains from an involuntary conversion under Section 117(j) of the Internal Revenue Code.

**Holding**

Yes, because the insurance proceeds compensated Meredith for the loss of his property (the improvements) and were not a disguised payment for cancellation of the lease. Section 117(j) applies, treating the gain as a capital gain from an involuntary conversion.

**Court's Reasoning**

The Tax Court emphasized that the lease agreement clearly stated the improvements became Meredith's property upon completion. The lessee only had the right to use the improvements during the lease term.
The court rejected the Commissioner's argument that the insurance proceeds were consideration for the lease cancellation. The lease cancellation agreement made no mention of such consideration.
The court distinguished this case from *Hort v. Commissioner*, where payments were received in lieu of rental income. Here, the insurance proceeds were compensation for the destruction of Meredith's property, not a substitute for rent.
The court noted that even if the lessee had used the insurance proceeds to rebuild, the new improvements would still belong to Meredith. This further supported the conclusion that Meredith was the equitable, as well as legal, owner of the improvements and the insurance proceeds.
The court found Regulation 111, Section 29.22(b)(11)-1, inapplicable because the insurance proceeds did not represent a

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