15 T.C. 906 (1950)

A taxpayer who inherits property subject to a long-term lease, under which the lessee constructed a building, is entitled to a depreciation deduction based on the fair market value of the building at the time of inheritance, but cannot amortize the favorable lease terms separately.

Summary

Mary Young Moore inherited a half interest in land and a building from her mother. The building was constructed by a lessee under a 99-year lease. Moore claimed a depreciation deduction on the building and amortization on the favorable lease terms. The Tax Court held that Moore was entitled to a depreciation deduction based on the fair market value of the building at the time of her mother's death. However, the court denied the amortization deduction, ruling that the right to receive rent is an incident of fee ownership, not a separate amortizable asset. The favorable lease terms were reflected in the overall value of the property, not as a distinct asset.

Facts

Petitioner, Mary Young Moore, and her mother owned land as tenants in common. In 1924, they entered into a 99-year lease with Sun Realty Co. The lease required Sun Realty to demolish existing buildings and construct a new building costing at least $2,000,000. Sun Realty constructed an 11-story building (Barker Bros. Building) at a cost of $2,132,000. In 1938, Moore's mother died, and Moore inherited her mother's half interest in the property. The estate tax valuation of the half interest was $1,533,100. Moore sought to deduct depreciation on the building and amortize a portion of the value allocated to the favorable lease terms.

Procedural History

The Commissioner of Internal Revenue disallowed Moore's depreciation and amortization deductions, leading to a deficiency assessment for the years 1943, 1944, and 1945. Moore petitioned the Tax Court for redetermination of the deficiencies and claimed overpayments. The Tax Court consolidated the proceedings.

Issue(s)

1. Whether the petitioner is entitled to a depreciation deduction on the inherited half interest in the building constructed by the lessee.
2. Whether the petitioner is entitled to an amortization deduction on the inherited half interest in the lease.
3. If a depreciation deduction is allowed, what was the fair market value of the building at the time of the decedent's death?

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Holding

1. Yes, because inheriting the property gives the taxpayer a depreciable interest in the building, measured by its fair market value at the time of inheritance.
2. No, because the right to receive rent is an incident of fee ownership and not a separate capital asset subject to amortization.

Court’s Reasoning

The Tax Court reasoned that under Section 23(l) of the Internal Revenue Code, a taxpayer is allowed a depreciation deduction if they have an investment or depreciable interest in the property. Although typically a lessor cannot depreciate a building constructed by a lessee, the court distinguished this case because Moore inherited the property. Citing *Charles Bertram Currier, 7 T.C. 980*, the court emphasized that the basis of inherited property is its fair market value at the date of acquisition, as per Section 113(a)(5) of the Internal Revenue Code. The court followed its holding in *J. Charles Pearson, Jr., 13 T.C. 851*, which involved similar facts. The court rejected the argument that the favorable lease terms created a separate amortizable asset. Quoting *Martha R. Peters, 4 T.C. 1236, 1240*, the court stated, “Since we are convinced that the right to receive income from the tenant is a part of the realty and passed by the deed of conveyance, it is immaterial whether the lease was advantageous or detrimental to the fee owner.”

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