17 T.C. 631 (1951)

When a taxpayer purchases property with the intent to demolish existing buildings and erect a new one, the entire purchase price is allocated to the land's basis, even if the demolition is later delayed or the original intent abandoned; depreciation allowed prior to the change in intent reduces the land's basis.

Summary

N. W. Ayer & Son's predecessor partnership bought land in 1920 intending to build a new office building, but changed plans due to a shift in the business district. The partnership transferred the land to the petitioner corporation in 1929. The buildings were demolished in 1933, and the land was sold in 1946. The Tax Court addressed how to determine the basis of the land for calculating gain or loss on the 1946 sale. The court held that because the initial intent was to demolish the buildings, the purchase price was allocable to the land, less depreciation allowed. The abandonment of the original intent did not change this initial allocation.

Facts

In 1920, the N. W. Ayer & Son partnership purchased property adjacent to their existing offices, consisting of three buildings, for $150,000. The partnership intended to demolish these buildings and construct a new office building for their expanding advertising business. An article in the Philadelphia Public Ledger announced these plans. The partnership used some of the space in the acquired buildings and rented out the rest. However, the business district shifted, and the partnership abandoned its construction plans, buying other property in 1926 and erecting a new building there in 1928. The buildings on the original property were eventually demolished in 1933. The land was sold in 1946 for $25,000.50.

Procedural History

The Commissioner of Internal Revenue determined a deficiency in N. W. Ayer & Son's 1946 income tax return. The dispute centered on the basis of the real property sold in 1946. The Commissioner argued for a basis of $80,500, while the petitioner contended for $138,276.23. The Tax Court was tasked with resolving this dispute.

Issue(s)

Whether the basis of real property, purchased with the intent to demolish existing buildings but where that intent was later abandoned, is the original purchase price less depreciation allowed, for purposes of determining gain or loss on a subsequent sale of the land.

Holding

Yes, because the initial intent at the time of purchase controls the allocation of the

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purchase price to the land, regardless of any subsequent change in plans.

Court's Reasoning

The court relied on Section 23(f) of the Internal Revenue Code and related regulations, which state that when a taxpayer buys property with the intent to demolish existing buildings to erect a new one, no deductible loss is allowed for the demolition. Instead, the value of the real estate is considered equal to the purchase price plus the demolition cost. The court emphasized that the taxpayer's intent at the time of purchase is the determinative factor, citing *Liberty Baking Co. v. Heiner*, 37 F.2d 703 (3d Cir. 1930), and *Providence Journal Co. v. Broderick*, 104 F.2d 614 (1st Cir. 1939). The court reasoned that because the partnership's initial intent was to demolish the existing buildings, the $150,000 purchase price represented the cost of the land. The subsequent abandonment of this intention was immaterial. The court stated, "The intent of the taxpayer on the date of purchase is, therefore, the determinative factor under the court decisions." Therefore, the loss suffered upon the sale of the land was the difference between the initial cost ($150,000) and the selling price ($25,000.50), less depreciation already claimed.

Practical Implications

This case illustrates the enduring importance of initial intent in tax law, specifically concerning the treatment of purchased property. It clarifies that a taxpayer's initial plan for the property at the time of purchase dictates the allocation of costs, even if those plans later change. This decision affects how businesses and individuals must document their intentions when acquiring property with existing structures. Subsequent cases must analyze the taxpayer's state of mind at the moment of purchase. The N. W. Ayer & Son case underscores that tax treatment is not always dictated by the final outcome, but by the original, documented purpose. It provides a clear rule for determining the basis in situations where the initial plan involved demolition. If the initial intent was demolition, the purchase price is attributed to the land and subsequent changes in plans do not alter the initial basis calculation. The key is establishing and documenting intent at the time of purchase.

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