17 T.C. 903 (1951)

A taxpayer may deduct depreciation and maintenance expenses on property formerly used as a personal residence if it is held for the production of income, but a loss on the sale of such property is deductible only if the property was converted to a transaction entered into for profit.

Summary

William Horrmann inherited a large residence from his mother and initially occupied it as his personal residence. After finding it unsuitable, he moved out and attempted to rent or sell the property. He later claimed deductions for depreciation and maintenance expenses, as well as a loss on the property's eventual sale. The Tax Court held that while Horrmann could deduct depreciation and maintenance expenses because the property was held for the production of income after he moved out, the loss on the sale was not deductible because he had not converted the property to a transaction entered into for profit.

Facts

William Horrmann inherited a large, expensive residence from his mother in February 1940. He spent $9,000 redecorating the house and moved in with his family in November 1940. In October 1942, Horrmann moved out, finding the house too large and expensive. He listed the property for sale or rent with realtors, who advertised it and showed it to prospective tenants. The property remained unrented and was vandalized in January 1945. It was eventually sold in June 1945 for $23,000, resulting in a loss.

Procedural History

The Commissioner of Internal Revenue denied Horrmann's deductions for depreciation and maintenance expenses, as well as the capital loss deduction. Horrmann petitioned the Tax Court, contesting the Commissioner's determination. The Tax Court addressed the deductibility of depreciation, maintenance expenses, and the capital loss.

Issue(s)

1. Whether Horrmann was entitled to deduct depreciation on the property during the years 1943, 1944, and 1945.
2. Whether Horrmann was entitled to deduct expenses incurred for the maintenance and conservation of the property during the years 1943 and 1944.
3. Whether Horrmann was entitled to a deduction for a long-term capital loss arising from the sale of the property in 1945.

Holding

1. Yes, because the property was held for the production of income after Horrmann abandoned it as a personal residence and made efforts to rent it.
2. Yes, because the property was held for the production of income, satisfying the requirement of Section 23(a)(2) of the Internal Revenue Code.
3. No, because Horrmann did not convert the property to a transaction entered into for profit.

Court's Reasoning

The court reasoned that to deduct depreciation under Section 23(l)(2) and maintenance expenses under Section 23(a)(2), the property must be "held for the production of income." The court found that after Horrmann abandoned the property as a personal residence and made efforts to rent it, it met this criterion, even though no income was actually received. The court cited *Mary Laughlin Robinson, 2 T.C. 305*, in support of this conclusion.

However, to deduct a loss under Section 23(e)(2), the loss must be "incurred in any transaction entered into for profit." The court distinguished this from the "held for the production of income" standard. The court found that merely abandoning the property and listing it for sale or rent was insufficient to convert it to a transaction entered into for profit. Quoting *Rumsey v. Commissioner, 82 F.2d 158*, the court emphasized that listing property with a broker for sale or rental does not irrevocably commit it to income-producing purposes. Since Horrmann took decisive actions to establish the property as his personal residence shortly after inheriting it, he needed to do more than simply offer it for sale or rent to convert it into a transaction entered into for profit.

Practical Implications

This case highlights the different standards for deducting expenses versus deducting losses when dealing with property that was once a personal residence. While efforts to rent the property can justify deductions for depreciation and maintenance, a higher threshold must be met to demonstrate that the property was converted to a transaction entered into for profit to deduct a loss on its sale. Taxpayers should be aware of this distinction and take concrete steps to demonstrate a profit-seeking motive, such as significant remodeling for commercial use or actual rental of the property, to support a loss deduction. This case is frequently cited when evaluating the deductibility of losses on the sale of inherited or formerly personal residences.