Nettie M. Fowler v. Commissioner, 1952 Tax Court (T.C.) 369

When a taxpayer converts property from personal use to rental use, the basis for determining gain or loss is the lesser of the property's cost or its fair market value at the time of conversion.

Summary

The taxpayer, Nettie Fowler, contested the Commissioner's determination of her tax liability following the sale of a property. Fowler claimed the property was purchased for rental purposes, thus entitling her to a cost basis. The Tax Court found the property was initially purchased as a residence for her brother. However, the Court also determined that Fowler converted the property to rental use after her brother's death. Because Fowler failed to present evidence of the property's fair market value at the time of conversion, the Court upheld the Commissioner's reduced basis determination. The Court also denied a deduction for a claimed loss on a transaction involving another property and determined that certain interest income was not taxable to Fowler.

Facts

- Nettie Fowler's father provided her with $22,000 to purchase a property.
- The property was purchased so that her brother could live there, and Fowler could look after him.
- From the date of purchase until his death in December 1929, Fowler's brother occupied the property as his residence, rent-free.
- After her brother's death, Fowler never occupied the property herself, but instead rented it out.
- In 1944, Fowler sold the property.
- Fowler also claimed a loss related to a property called "Belle Terre," which she inherited from her mother.
- Fowler received $600 as her share of interest that accrued on bonds prior to her mother's death.

Procedural History

The Commissioner of Internal Revenue adjusted Fowler's tax liability. Fowler petitioned the Tax Court for a redetermination of the deficiencies, challenging the Commissioner's adjustments related to the sale of the Natick property, the Belle Terre property, and the interest income.

Issue(s)

1. Whether the Tax Court erred in determining the basis of the Natick property sold in 1944.
2. Whether the Tax Court erred in disallowing a deduction for a claimed loss on the Belle Terre property transaction.

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3. Whether the Tax Court erred in including in Fowler's taxable income for 1944 the sum of $600 she received as her share of interest that accrued on certain bonds prior to her mother's death.

Holding

1. No, because Fowler failed to provide evidence of the property's fair market value at the time of conversion to rental property.
2. No, because Fowler did not demonstrate that a loss was actually incurred in the Belle Terre property transaction.
3. No, because the interest accrued prior to Fowler's mother's death and should have been included in the mother's final return.

Court's Reasoning

The Court reasoned that the Natick property was initially acquired as a personal family residence. However, upon the brother's death, it was converted to rental property. The court cited Treasury Regulation § 29.23(e)-1, which states that when residential property is converted to income-producing purposes, the basis is the lesser of cost or market value at the time of conversion. Because Fowler presented no evidence of the market value at the time of conversion, she failed to meet her burden of proof. As the court stated, "Wherever any such conversion of property purchased by the taxpayer takes place, the proper basis (unadjusted) is cost or market value on the date of conversion, whichever is the lesser… and the burden of proving basis is on the taxpayer." Regarding the Belle Terre property, the Court viewed the arrangement between the sisters as a special one, and found no loss was actually incurred. The Court noted that Fowler continued to use the property as a personal summer residence, indicating that the expenses were personal and not deductible. Finally, the Court held that the interest income was not taxable to Fowler because it had accrued prior to her mother's death and should have been included in her mother's final income tax return, citing Section 42 of the Internal Revenue Code (prior to amendment by the 1942 Revenue Act).

Practical Implications

This case highlights the importance of establishing the fair market value of property at the time it is converted from personal use to business or rental use. Taxpayers must maintain accurate records and obtain appraisals at the time of conversion to properly calculate their basis for depreciation and for determining gain or loss upon the sale of the property. This case reinforces that the burden of proof rests on the taxpayer to substantiate their claimed basis. It serves as a reminder that transactions between related parties will be subject to closer scrutiny, and that personal use of property can negate the deductibility of related expenses.

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