22 T.C. 1172 (1954)

When property is involuntarily converted, the replacement property is considered "similar or related in service or use" for nonrecognition of gain under Section 112(f) of the Internal Revenue Code if its function and purpose are substantially the same as the converted property, even if the physical characteristics differ.

Summary

Gaynor News Company, Inc. (petitioner) sought nonrecognition of gain from the involuntary conversion of its property through condemnation. The company intended to build a plant for its newspaper distribution business on the condemned land, which was subsequently cleared of existing structures. The company used the proceeds to purchase the stock of a corporation whose sole asset was property intended for the new plant. The Commissioner of Internal Revenue argued the new, improved property was not similar in use to the unimproved condemned land. The Tax Court held the replacement property qualified for nonrecognition of gain, focusing on the identical function and purpose of the properties, despite differences in their physical condition.

Facts

In 1948, Gaynor News Company acquired property (old property) in Mt. Vernon, New York, for a newspaper distribution plant, initially renting existing buildings. The company planned to remove existing improvements and construct a suitable plant. In 1949, the city of Mt. Vernon condemned the property. Gaynor News received $80,000 for the old property. On the same day, the company purchased all the capital stock of 217 South Fourth Avenue Corporation for $87,254.54. The sole asset of this corporation (new property) was land improved with a building. The company intended to use this new property to build its plant. The existing building on the new property was not suitable, and parts of the building had to be demolished. Both properties were located within a few blocks of each other.

Procedural History

The Commissioner of Internal Revenue determined a deficiency in Gaynor News's 1949 income tax return, disallowing nonrecognition of gain under Section 112(f) of the 1939 Internal Revenue Code. Gaynor News contested this determination in the United States Tax Court.

Issue(s)

Whether the new property was "similar or related in service or use" to the old property, thus entitling Gaynor News to nonrecognition of gain under Section 112(f) of the Internal Revenue Code.

Holding

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Yes, because the court determined that the new property was similar or related in service or use to the old property.

Court’s Reasoning

The court focused on the function and purpose of the properties. The court rejected the Commissioner’s argument that because the old property was unimproved when condemned and the new property was improved, they were not similar. The court determined the key was that both properties were intended for the same ultimate use: the construction of a plant for Gaynor News’s business. The court found the old property was in the process of being prepared for the construction of a building for a specific business use at the time of condemnation. “The goal in each instance was identical — the erection of a plant adapted to petitioner’s business.” It found the fact that the new property already had some improvements, which were then partially demolished, did not change the nature of the properties’ intended use and the court found that the government’s argument hinged on an overly strict interpretation of

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