Grahm v. Commissioner, 26 T.C. 315 (1956)

A taxpayer may not deduct real estate taxes as a tax paid under federal law if, at the time of property acquisition, the taxes had already become a lien on the property and the prior owner was personally liable, even if the purchaser assumed the obligation to pay the taxes under state law.

Summary

The U.S. Tax Court addressed whether the petitioners, who purchased Connecticut real estate, could deduct real estate taxes they paid, even though the taxes were a lien on the property and the prior owner was liable before the sale. The court held that the petitioners could not deduct these taxes under Section 23(c) of the Internal Revenue Code of 1939. The court reasoned that under the established precedent, specifically *Magruder v. Supplee*, the payment of taxes by a purchaser to discharge a pre-existing lien is not a tax payment in the proper sense, but part of the purchase price. The court further found that a Connecticut state law making the purchaser liable for taxes did not change this federal tax treatment because it did not alter the fact that the tax was initially imposed on the vendor and the lien existed before the purchase.

Facts

Milton L. Grahm, Edith L. Grahm, Ira Gerler, Selma L. Gerler, Harold Singer, and Esther L. Singer (petitioners), all married couples, resided in Massachusetts and filed joint federal income tax returns. The wives acquired equal interests in real estate located in Connecticut on November 1, 1948, and the property was held in the name of a partnership. The real estate taxes were levied and became a lien on the property as of October 1, 1948. The prior owner was personally liable for these taxes. The partnership expressly agreed to pay all taxes levied after September 1, 1948. In 1949, the partnership paid the real estate taxes, and the husbands and wives claimed deductions for their proportional shares on their tax returns, which the Commissioner disallowed.

Procedural History

The Commissioner of Internal Revenue determined deficiencies in the petitioners' income taxes for 1949 and 1950, disallowing the claimed deductions for real estate taxes. The petitioners contested the deficiencies. The cases were consolidated in the United States Tax Court.

Issue(s)

Whether the petitioners are entitled to deduct, under section 23(c) of the Internal Revenue Code of 1939, the real estate taxes paid by the partnership.

Holding

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No, because under federal tax law, the payment of a pre-existing tax lien by a purchaser is not considered a tax payment but part of the purchase price.

Court’s Reasoning

The Court relied on Section 23(c) of the Internal Revenue Code of 1939 which allows a deduction for

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