29 T.C. 670 (1958)

For property acquired in an involuntary conversion to qualify for nonrecognition of gain under I.R.C. § 1033 (now I.R.C. § 1033), the replacement property must be similar or related in service or use to the converted property.

Summary

The United States Tax Court held that the taxpayers, the Collins, were not entitled to nonrecognition of gain on the sale of their poultry farm due to threat of condemnation when they used the proceeds to purchase rental property and a gas station business. The court determined that the properties acquired were not similar or related in service or use to the poultry farm, thereby failing to meet the requirements of I.R.C. § 112(f) (now I.R.C. § 1033). This case emphasizes that the "similar or related in service or use" test is a functional one, meaning the new property must serve a similar function as the old property to qualify for tax deferral.

Facts

The State of Virginia threatened to condemn 2.68 acres of land owned by Denny and Kathryn Collins for the expansion of a state highway. The Collins' property included their residence, a garage, chicken houses, and tourist cabins. Under the threat of condemnation, the Collins agreed to sell the land and chicken houses to the state. They retained their residence, garage, and tourist cabins, which were moved to adjacent land. The Collins received $41,000 in compensation, allocated for the land, chicken houses, and relocation expenses. Following the involuntary conversion, the Collins ceased their poultry business. They subsequently purchased two houses for rental purposes and a partnership interest in a gasoline service station.

Procedural History

The Commissioner of Internal Revenue determined a deficiency in the Collins' income tax for 1953, disallowing the nonrecognition of gain from the sale of their property. The Collins contested this determination, arguing that they should not recognize the gain because they reinvested the proceeds. The case was brought before the United States Tax Court.

Issue(s)

1. Whether the Collins' purchase of rental properties and a gasoline station business satisfied the "similar or related in service or use" requirement of I.R.C. § 112(f) (now I.R.C. § 1033) for nonrecognition of gain following an involuntary conversion.

Holding

1. No, because the properties acquired were not similar or related in service or use to the property converted.

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Court’s Reasoning

The court relied on I.R.C. § 112(f) (now I.R.C. § 1033) which allows for the nonrecognition of gain from an involuntary conversion if the proceeds are used to acquire property similar or related in service or use. The court noted that this is a relief provision, but taxpayers must meet the precise statutory requirements to qualify. The court applied a functional test, stating, “the test as to whether the property acquired is similar or related in service or use to the property converted is a functional one.” The court found that the Collins’ poultry business was not functionally similar to the subsequent rental properties or the gas station. Because the Collins did not reinvest in property similar in use to the poultry business, the court held they did not qualify for the nonrecognition of gain.

Practical Implications

This case underscores the importance of the

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