T.C. Memo. 1960-205

When a portion of a larger property is sold, the cost basis must be equitably apportioned among the parts based on their relative fair market values at the time of acquisition, not solely on a pro-rata square footage basis; furthermore, improvements made to retained property cannot be added to the basis of sold parcels.

Summary

Fairfield Plaza, Inc. purchased a 10-acre tract to develop a shopping center. They sold two portions, the Big Bear tract in 1957 and the Paisley tract in 1958. Disputing the IRS's basis allocation, Fairfield Plaza argued for including escrowed improvement funds in the basis of the sold parcels and for a basis allocation method other than pro-rata square footage. The Tax Court ruled that basis allocation must be equitable, reflecting relative fair market values, and that improvements to retained land cannot increase the basis of sold parcels. The court determined the basis allocation should reflect the higher value of the Paisley tract due to its prime street frontage, diverging from a simple square footage approach.

Facts

Fairfield Plaza, Inc. acquired a 10-acre tract in Huntington, West Virginia, in 1955 for $100,000 with the intention to develop a drive-in shopping center. Initial costs, including commissions, interest, taxes, legal, and insurance, totaled $110,941.12. Development costs for grading, engineering, and miscellaneous items added $29,584.64, bringing the total capitalized cost to $140,525.76. In 1957, Fairfield Plaza sold the "Big Bear tract," the easterly portion, for $100,000, with $50,000 placed in escrow for paving and lighting on the retained portion. In 1958, the "Paisley tract," the westerly portion, was sold for $150,000. Fairfield Plaza subsequently spent $40,146.32 on paving and lighting the retained center tract.

Procedural History

The Commissioner of Internal Revenue determined deficiencies in Fairfield Plaza's income taxes for 1957 and 1958. Fairfield Plaza contested these deficiencies in Tax Court, challenging the Commissioner's allocation of basis for the sold parcels and the disallowance of adding escrowed funds to the basis of the Big Bear tract.

Issue(s)

1. Whether the cost basis of a single tract of real estate, when portions are sold separately, should be allocated based on a pro-rata square footage method or equitably based on the relative fair market values of each portion at the time of acquisition.

© 2025 SCOTUSreports.com. All rights reserved.

2. Whether any portion of funds escrowed for improvements to the retained center portion of the property, or the actual cost of such improvements, can be added to the basis of the parcels sold in 1957 and 1958.

Holding

1. No, because equitable apportionment of basis requires reflecting the relative fair market values of the different portions of the property, not merely a pro-rata allocation by square footage. The court found the Paisley tract had a higher relative value due to its frontage on a main thoroughfare.

2. No, because improvements made to property retained by the seller, even if related to the overall development plan, cannot be added to the basis of parcels already sold.

Court's Reasoning

The court reasoned that Treasury Regulations Section 1.61-6 mandates an "equitable" apportionment of basis when part of a larger property is sold. "Such 'equitable' apportionment demands that relative values be reflected. Accordingly, if one parcel is of greater value than another, apportionment solely on the basis of square footage appears inappropriate." The court cited *Biscayne Bay Islands Co., 23 B.T.A. 731*, and *Cleveland-Sandusky Brewing Corp., 30 T.C. 539*, to support this principle. Expert testimony and the significantly higher sales price of the Paisley tract (fronting on 16th Street, a main thoroughfare) compared to the Big Bear tract (fronting on 17th Street) demonstrated that the Paisley tract had a greater relative value at the time of purchase. The court allocated 40% of the initial land cost to the Paisley parcel and 30% to the Big Bear parcel, adjusting from the Commissioner's near equal allocation based on square footage. Regarding the improvement costs, the court held that "improvements to property retained by the petitioner which may be sold at a later date may not be added to basis of another parcel in the tract," citing *Colony, Inc., 26 T.C. 30*. Since the $40,146.32 was spent on the retained center tract, it could not be included in the basis of the Big Bear or Paisley tracts.

Practical Implications

This case emphasizes that when selling portions of a larger real estate property, taxpayers must equitably allocate the original cost basis to each sold portion, reflecting their relative fair market values at the time of acquisition, not just based on square footage. Factors such as location, street frontage, and accessibility significantly influence relative values and must be considered in basis allocation. Legal professionals and taxpayers should ensure appraisals and valuations at the time of acquisition accurately reflect these value differences to support equitable

© 2025 SCOTUSreports.com. All rights reserved.

basis allocation upon subsequent sales of portions of the property. Furthermore, costs associated with improving retained property cannot be used to increase the basis of sold properties, even if those improvements were part of a broader development plan. This ruling clarifies that basis adjustments for improvements are generally limited to the specific parcel being improved or, in some cases, equitably allocated across an entire subdivision under a common development plan, but not across separately sold and retained parcels in the manner attempted by the petitioner.

© 2025 SCOTUSreports.com. All rights reserved.