Davies v. Commissioner, 54 T. C. 170 (1970)

Gain from the sale of a residence is not eligible for nonrecognition under Section 1034 if the property is held by a land trust and treated as business property.

Summary

Blanche F. Davies sought nonrecognition of gain under Section 1034 after selling an apartment building held in an Illinois land trust, where she resided in one unit. The court ruled that the property was business property due to the trust's treatment and thus ineligible for Section 1034 nonrecognition. Additionally, Davies' claim for a bad debt deduction for loans to the trust was denied because she chose not to collect the debt, failing to establish its worthlessness.

Facts

Blanche F. Davies and her sister transferred an apartment building to an Illinois land trust in 1957, with Davies and four other family members as beneficiaries. Davies lived in one of the three apartments, paying rent and managing the property. The building was sold in 1965, and Davies used her share of the proceeds to purchase a new home. She claimed nonrecognition of gain under Section 1034 and a bad debt deduction for loans made to the trust.

Procedural History

The Commissioner of Internal Revenue determined a deficiency in Davies' 1965 federal income tax and denied her claimed deductions. Davies petitioned the U. S. Tax Court, which heard the case and issued its decision on February 5, 1970.

Issue(s)

1. Whether any part of the capital gain realized upon the sale of the apartment building qualifies for nonrecognition under Section 1034 when the property was held by an Illinois land trust?
2. Whether Davies is entitled to a bad debt deduction for loans made to the land trust?

Holding

1. No, because the apartment Davies resided in was treated as business property by the land trust, making it ineligible for nonrecognition under Section 1034.
2. No, because Davies did not establish that the loans to the trust became worthless; she chose not to collect them.

Court's Reasoning

The court determined that the apartment building was business property due to the

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land trust’s treatment, which included Davies paying rent and the trust claiming depreciation. This distinguished the property from a personal residence eligible for Section 1034 nonrecognition. The court noted that the trust was an entity that changed the tax treatment of the property, and it could not be ignored for Section 1034 purposes. Regarding the bad debt issue, the court found that Davies had a bona fide debt but failed to prove its worthlessness, as she chose not to collect it to avoid family conflict and delays in distribution.

Practical Implications

This decision clarifies that property held in a land trust and treated as business property does not qualify for nonrecognition of gain under Section 1034, even if used as a residence. Taxpayers must carefully consider the tax treatment of property held in trusts or partnerships when planning to sell and replace their residences. The case also underscores the need to establish the worthlessness of a debt to claim a bad debt deduction, particularly when personal relationships are involved. Subsequent cases may reference Davies when addressing the interplay between property ownership structures and tax treatment of gains or losses.

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