***Herman v. Commissioner, 54 T. C. 765 (1970)***

A lessor cannot claim a demolition loss deduction if the demolition was within the contemplation of the parties at the time the lease was executed, even if not formally mandated by the lease.

## Summary

In Herman v. Commissioner, the Tax Court ruled that a partnership could not claim a demolition loss under Section 165(a) when the demolition of a building was an integral part of the lease negotiations with the lessee. The court interpreted IRS Regulation 1. 165-3(b)(2) to mean that no deduction is allowed if the demolition was a contemplated requirement at the time of the lease, regardless of whether it was formally mandated. The court emphasized the economic context of the lease and the parties' intentions, rejecting the lessor's claim for an immediate loss deduction and instead allowing the adjusted basis to be amortized over the lease term.

## Facts

Herman and Investment were partners in a partnership that owned a building leased to a tenant. The lease negotiations included discussions about demolishing the existing building and disposing of its contents, which were considered essential to the lease agreement. The demolition and disposal began shortly after the lease term commenced. The partnership claimed a demolition loss deduction for the adjusted basis of the building, fixtures, and equipment, but the IRS disallowed the deduction, requiring the basis to be amortized over the remaining lease term.

## Procedural History

The IRS issued a notice of deficiency disallowing the partnership's claimed demolition loss deduction. The partnership petitioned the Tax Court for a redetermination of the deficiency. The Tax Court reviewed the case and issued its opinion, upholding the IRS's position.

## Issue(s)

1. Whether the partnership is entitled to a loss deduction under Section 165(a) for the demolition of a building by a lessee, when the demolition was contemplated by the parties at the time of the lease but not formally required by the lease terms.

## Holding

1. No, because the demolition was within the contemplation of the parties at the time the lease was executed and thus considered a requirement of the lease under IRS Regulation 1. 165-3(b)(2).

## Court's Reasoning

The Tax Court focused on the intent of the parties at the time the lease was negotiated, finding that the demolition was an essential condition of the lease. The court interpreted the regulation’s use of “requirements” to include any demolition contemplated by the parties, not just those formally mandated. The court distinguished this case from Feldman v. Wood, where the demolition was not contemplated at the time of the lease. The court also referenced prior case law that examined the economic context of demolitions in lease situations, emphasizing that the lessor’s loss was to be amortized over the lease term rather than taken as an immediate deduction. The court noted that the regulation aimed to prevent lessors from claiming immediate losses for demolitions that were part of the lease’s underlying conditions.

**Practical Implications**

This decision clarifies that lessors cannot claim immediate demolition loss deductions when the demolition is contemplated at the time of the lease, even if not formally required. Practitioners should carefully review lease agreements to determine if demolition was part of the negotiations, as this could affect the tax treatment of any demolition. The ruling reinforces the importance of the economic context of lease agreements in tax law and may impact how businesses structure lease and demolition arrangements. Subsequent cases have followed this reasoning, emphasizing the intent of the parties and the lease’s economic purpose in determining the tax treatment of demolition losses.

 