Warner v. Commissioner, 56 T. C. 1126 (1971)

Nonrecognition of gain under IRC § 1033 requires that property be sold under an actual threat or imminence of condemnation, not merely a remote possibility.

Summary

In Warner v. Commissioner, the taxpayers sought nonrecognition of gain under IRC § 1033 for the sale of land, claiming it was sold under threat of condemnation by the State of Michigan or a public utility. The Tax Court held that the taxpayers were not entitled to nonrecognition because no actual threat or imminence of condemnation existed. The court found that the State's limited funding and explicit statements against condemnation negated any real threat. Additionally, the court reallocated the sales proceeds among the properties sold, determining that the allocation proposed by the taxpayers was incorrect.

Facts

Edward and Elizabeth Warner owned several tracts of land in Van Buren County, Michigan. In 1964, the State of Michigan was exploring the possibility of acquiring land in the area for a state park. The State's agent, Tucker, informed Warner of the State's interest and funding limitations, explicitly stating that condemnation was unlikely. Simultaneously, Consumers Power Company (CPC) was secretly acquiring land in the same area for a power plant. Warner sold his properties to an agent of CPC in December 1964 and January 1965. Warner claimed that the sales were under threat of condemnation by the State or CPC, electing nonrecognition of gain under IRC § 1033 on his 1965 tax return.

Procedural History

The Commissioner of Internal Revenue determined a deficiency in the Warners' 1965 income tax and disallowed the nonrecognition of gain. The Warners petitioned the U. S. Tax Court for a redetermination of the deficiency. The court heard the case and issued its opinion on August 23, 1971.

Issue(s)

1. Whether the Warners sold their property under threat or imminence of condemnation by the State of Michigan or Consumers Power Company, thereby entitling them to nonrecognition of gain under IRC § 1033?
2. Whether the Commissioner's allocation of the sales proceeds among the various properties was correct?

Holding

1. No, because the court found no actual threat or imminence of condemnation. The State's agent explicitly stated that condemnation was unlikely due to funding

limitations, and there was no evidence of a threat from CPC.
2. No, because the court determined that the $2,000 per acre figure in the sales agreement was more a penalty for non-performance than an indication of value, and reallocated the proceeds accordingly.

Court's Reasoning

The court applied IRC § 1033, which allows nonrecognition of gain if property is sold under threat or imminence of condemnation. The court emphasized that the threat must be actual and imminent, not merely a remote possibility. The State's agent, Tucker, had explicitly informed Warner that condemnation was unlikely due to funding issues, which negated any real threat. The court found Warner's testimony about being told of a threat by CPC's agent to be unconvincing and contradicted by other evidence. The court also considered prior cases where actual notice or a reasonable inference of condemnation was necessary for nonrecognition under § 1033. The court distinguished this case from others where taxpayers had actual notice or a compelling reason to infer condemnation. Regarding the allocation of proceeds, the court found that the $2,000 per acre figure in the sales agreement was a penalty rather than a valuation, and thus reallocated the proceeds based on the properties' characteristics and market values.

Practical Implications

This decision clarifies that for nonrecognition of gain under IRC § 1033, taxpayers must demonstrate an actual threat or imminence of condemnation, not just a remote possibility. Tax practitioners must carefully assess the facts surrounding a property sale to determine if the threat of condemnation is sufficiently imminent and credible. The ruling underscores the importance of explicit statements and actions by condemning authorities in establishing a threat. In practice, attorneys advising clients on potential § 1033 elections should ensure thorough documentation of any communications or actions indicating a threat of condemnation. The decision also impacts how sales proceeds are allocated for tax purposes, emphasizing that contract terms may not always reflect actual property values. Subsequent cases have cited Warner v. Commissioner in analyzing the sufficiency of a threat of condemnation for § 1033 purposes, reinforcing its significance in tax law.

