Ferreira v. Commissioner, 57 T. C. 866 (1972)

Payments for delay in condemnation proceedings, even if labeled as ‘blight damages,’ are taxable as ordinary income under IRC Section 61(a).

Summary

In Ferreira v. Commissioner, the Ferreiras received $26,000 as part of a condemnation award, labeled as ‘interest by way of damages’ for delay in payment. The key issue was whether this amount was taxable as ordinary income. The Tax Court held that such payments, regardless of their label under state law, are taxable as ordinary income because they compensate for the delay in receiving the condemnation award, not as part of the property’s sale price. The court’s reasoning was influenced by the Supreme Court’s decision in Kieselbach v. Commissioner, emphasizing that compensation for delay is ordinary income under IRC Section 61(a).

Facts

In 1961, the Honolulu Redevelopment Agency initiated condemnation proceedings against the Ferreiras’ property. After litigation, the Ferreiras were awarded $111,000 in 1967, which included $26,000 described as ‘interest by way of damages’ from the date of summons to the date of judgment, offset by the reasonable value of their possession during that period. The Ferreiras did not report the $26,000 as income, leading to the Commissioner’s determination of a deficiency.

Procedural History

The Commissioner determined a deficiency in the Ferreiras’ 1967 income tax. The Ferreiras contested this in the U. S. Tax Court, arguing the $26,000 was non-taxable ‘blight damages’ under Hawaii law. The Tax Court ultimately ruled in favor of the Commissioner, holding the $26,000 taxable as ordinary income.

Issue(s)

1. Whether the $26,000 received by the Ferreiras as part of a condemnation award, described as ‘interest by way of damages,’ is taxable as ordinary income under IRC Section 61(a).

Holding

1. Yes, because the $26,000 was compensation for the delay in receiving the condemnation award and not part of the property’s sale price, it is taxable as ordinary income under IRC Section 61(a).

Court’s Reasoning

The Tax Court relied on the Supreme Court's decision in Kieselbach v. Commissioner, which established that payments for delay in condemnation awards are ordinary income. The court noted that under Hawaii law, 'blight damages' are akin to interest for the delay between the summons and payment, not reflecting any increase in property value. The court emphasized that the $26,000 was calculated as 'interest' from the date of summons to judgment, offset by the value of the Ferreiras' continued possession. The court rejected the Ferreiras' argument that the payment was non-taxable under IRC Section 104 as damages for personal injury, finding no evidence of personal injury. The court concluded that the payment's purpose was to compensate for the delay in payment, making it taxable under IRC Section 61(a).

Practical Implications

This decision clarifies that payments labeled as 'blight damages' or similar under state law, when compensating for delay in condemnation proceedings, are taxable as ordinary income. Attorneys should advise clients in condemnation cases that such payments will be taxed at ordinary rates, not as part of the capital gain from the property sale. This ruling impacts how condemnation awards are structured and reported for tax purposes, potentially affecting negotiations and the timing of payments in such proceedings. Subsequent cases have followed this precedent, reinforcing the tax treatment of delay-related payments in condemnation awards.

