Boesel v. Commissioner, 65 T. C. 378 (1975)

The cost of purchasing a new residence for purposes of nonrecognition of gain under section 1034 does not include the discounted present value of future lease payments for the land on which the residence is situated.

Summary

In Boesel v. Commissioner, the taxpayers sold their Connecticut home and purchased a new residence in California situated on leased land. They attempted to include the present value of future lease payments in the cost of the new residence to defer gain recognition under section 1034. The Tax Court held that such lease payments are not part of the purchase price, as they do not represent an equity interest in the land. The court emphasized the necessity of holding title to the new residence in fee simple to qualify for nonrecognition treatment, and thus upheld the Commissioner's determination of a taxable gain on the sale of the old residence.

Facts

In September 1968, Richard E. Boesel, Jr. , was transferred by his employer from New York to San Francisco. The Boesels sold their residence in Greenwich, Connecticut, for $162,307 and purchased a new home in Belvedere, California, for $138,222. The new residence was built on land leased for 75 years, with 73 years remaining on the lease at the time of purchase. The Boesels assumed the lease and sought to include the discounted present value of future lease payments ($29,148) in the cost of the new residence to avoid recognizing gain on the sale of their old home.

Procedural History

The Commissioner of Internal Revenue determined a deficiency in the Boesels' 1968 federal income tax, asserting that the present value of the lease payments should not be included in the cost of the new residence for nonrecognition purposes under section 1034. The Boesels petitioned the U. S. Tax Court for a redetermination of the deficiency. The Tax Court upheld the Commissioner's position and ruled against the Boesels.

Issue(s)

1. Whether the discounted present value of future lease payments on the land upon which the new residence is situated can be included in the cost of purchasing the new residence for purposes of nonrecognition of gain under section 1034.

Holding

1. No, because the lease payments do not represent an equity interest in the land, and section 1034 requires the taxpayer to hold title to the new residence in fee simple to qualify for nonrecognition of gain.

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Court’s Reasoning

The Tax Court reasoned that section 1034 requires taxpayers to hold title in fee simple to the new residence to defer recognition of gain from the sale of the old residence. The court rejected the Boesels’ argument that a 73-year lease was equivalent to fee simple ownership, emphasizing that under California law, a leasehold is considered personal property, not real property. The court also distinguished section 1034 from sections 1031 and 1033, noting that the former applies to individual homeowners seeking to reinvest in their own homes, whereas the latter sections govern different types of property transactions. The court concluded that lease payments are ordinary recurring expenses and not capital expenditures, thus not includable in the cost of the new residence for nonrecognition purposes. The court approved Revenue Ruling 72-266, which supports this interpretation.

Practical Implications

This decision clarifies that for nonrecognition of gain under section 1034, taxpayers must purchase a new residence in fee simple, and cannot include the value of lease payments for the underlying land in the purchase price. Practitioners should advise clients to consider the form of ownership when planning to defer gains on the sale of a primary residence. This ruling may affect individuals in regions where long-term leases are common for residential properties. Subsequent cases have followed this precedent, reinforcing the requirement of fee simple ownership for section 1034 to apply. The decision also underscores the distinction between sections 1031 and 1033, which allow for nonrecognition in different scenarios involving leases, and section 1034, which is more narrowly tailored to individual homeowners.

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