Chevy Chase Land Co. v. Commissioner, 72 T. C. 481 (1979)

Costs of negotiating a lease and unsuccessful rezoning efforts are deductible as an abandonment loss if they become worthless upon termination of a contingent transaction.

Summary

Chevy Chase Land Co. sought to lease land to Federated Department Stores for a Bloomingdale's store, contingent on rezoning. After the rezoning was denied, Federated terminated the lease agreement. The Tax Court held that, except for a topographical map, the costs incurred in negotiating the lease and rezoning efforts were deductible as an abandonment loss under Section 165(a) of the IRC, as these costs became suddenly and permanently useless upon the transaction's termination.

Facts

Chevy Chase Land Co. owned a 19. 398-acre tract zoned for single-family homes. In 1970, it negotiated with Federated Department Stores to lease the tract for a Bloomingdale's store, contingent on rezoning to commercial use. They filed a rezoning application, but it was denied in 1971. Federated then terminated the lease agreement. Chevy Chase incurred $107,232. 80 in costs for lease negotiations and rezoning efforts, including a $1,500 topographical map.

Procedural History

The Commissioner determined a deficiency in Chevy Chase's 1971 income tax. Chevy Chase petitioned the Tax Court, seeking to deduct the $107,232. 80 as an abandonment loss. The Tax Court held that, except for the topographical map, the costs were deductible.

Issue(s)

1. Whether the costs of negotiating a prospective long-term lease and unsuccessful rezoning efforts are deductible as an abandonment loss under Section 165(a) of the IRC upon termination of the lease transaction?

Holding

1. Yes, because the costs became suddenly and permanently useless upon the termination of the transaction contingent on the rezoning, except for the cost of the topographical map which retained value.

Court's Reasoning

The Tax Court applied the principle that a loss is deductible when it is evidenced by closed and completed transactions and identifiable events. The court found that the rezoning effort was inextricably tied to the lease transaction, and when the rezoning failed, the entire transaction ended abruptly. The court cited Lucas v. American Code Co. for the practical test of when a loss is sustained. It distinguished this case from others where rezoning costs were not deductible, noting that here, the costs were for a specific, abandoned project. The court emphasized that the assets involved were intangible and separable from the land, capable of being abandoned. The topographical map was excluded from the deductible loss because it retained value for future use.

Practical Implications

This decision clarifies that costs related to a specific, contingent transaction can be deducted as an abandonment loss if they become worthless upon the transaction's failure. It impacts how businesses should account for costs of unsuccessful development projects, particularly when tied to specific outcomes like rezoning. The ruling encourages careful documentation of the purpose and contingency of such costs. It also distinguishes between assets that retain value and those that do not, guiding future tax planning and reporting. Subsequent cases like A. J. Industries, Inc. v. United States have cited this case in the context of abandonment losses for intangible assets.

