Gundersheim v. Commissioner, 74 T. C. 573 (1980)

A converted commercial building can qualify as a "new principal residence" for the purpose of claiming a tax credit under section 44 if it has never been used as a residence before.

Summary

In Gundersheim v. Commissioner, the Tax Court ruled that a cooperative apartment in a building previously used for commercial purposes qualified as a "new principal residence" under section 44 of the Internal Revenue Code of 1954, entitling the petitioners to a tax credit. The building was converted to residential use before March 26, 1975, and the petitioners were the first to use their purchased unit as a residence. The court emphasized that the "original use" requirement pertains to residential use, not any use of the property, thereby distinguishing this case from those involving renovations of previously residential properties.

Facts

In late 1974, Pronova Associates acquired a commercial property in New York and began converting it into residential use. The property was transferred to a cooperative corporation, which started selling shares in November 1974. In July 1975, the Gundersheims contracted to purchase 100 shares in the cooperative, entitling them to a proprietary lease on the fourth floor, previously used commercially. They paid $37,000 on August 27, 1975, and moved in as their principal residence in September 1975. The Gundersheims claimed a section 44 tax credit for the purchase of a "new principal residence" on their 1975 tax return, which was disallowed by the Commissioner.

Procedural History

The Gundersheims filed a petition with the U. S. Tax Court challenging the Commissioner's disallowance of their section 44 tax credit. The Tax Court, in a decision issued on June 12, 1980, ruled in favor of the Gundersheims, allowing the tax credit.

Issue(s)

1. Whether a cooperative apartment in a building previously used for commercial purposes qualifies as a "new principal residence" under section 44 of the Internal Revenue Code of 1954.

Holding

1. Yes, because the building had never been used for residential purposes before the petitioners' occupancy, and the conversion began before March 26, 1975, as required by section 44.

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Court’s Reasoning

The court focused on the definition of “new principal residence” in section 44(c)(1) and the regulations under section 1. 44-5(a), which specify that “original use” means the first use of the property as a residence. The court rejected the Commissioner’s argument that the property was merely renovated, as the renovations did not convert a previously residential property but rather added new housing stock. The court interpreted the legislative intent of section 44 as aimed at incentivizing the purchase of new additions to the nation’s housing stock, which included properties like the Gundersheims’ that were converted from commercial to residential use. The court also noted that the regulation’s reference to “renovated building” was meant to apply to previously residential properties, not buildings converted from non-residential use.

Practical Implications

This decision expands the applicability of the section 44 tax credit to include properties converted from non-residential to residential use, provided they have never been used as a residence before. Legal practitioners advising clients on tax credits for home purchases should consider this ruling when dealing with conversions of commercial properties into residential units. The decision encourages the conversion of existing commercial structures into housing, contributing to the nation’s housing stock. Subsequent cases might reference this decision when determining eligibility for similar tax credits, particularly in scenarios involving property conversions.

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