Bolaris v. Commissioner, 87 T. C. 1039 (1986)

A taxpayer can defer gain recognition under section 1034 despite temporarily renting their former residence if the rental is ancillary to sales efforts and not for profit.

Summary

In Bolaris v. Commissioner, the Tax Court addressed whether taxpayers could defer gain recognition on the sale of their former residence under section 1034 after temporarily renting it while attempting to sell. The court found that the temporary rental did not preclude section 1034's application, as the primary motive was to sell, not profit from rent. However, the court denied deductions for depreciation and expenses under sections 162, 167, and 212, ruling that the rental was not engaged in for profit. This case illustrates the distinction between property held for personal use and for income production, impacting how taxpayers handle the transition from residence to rental property.

Facts

Stephen and Valerie Bolaris purchased a home in San Jose, California in 1975, using it as their principal residence until October 1977. In July 1977, they listed the property for sale and began constructing a new home. Unable to sell, they rented the old residence from October 1977 to May 1978, and again for a short period before its sale in August 1978. The Bolarises reported rental income and claimed deductions for expenses and depreciation. The Commissioner challenged these deductions, asserting the rental was not for profit, and questioned the applicability of section 1034 due to the rental period.

Procedural History

The Commissioner determined deficiencies in the Bolarises' 1977 and 1978 federal income taxes and later asserted an increased deficiency for 1978. The case was assigned to Special Trial Judge Fred S. Gilbert, Jr. , who issued an opinion adopted by the full Tax Court. The court reviewed the case and held that the Bolarises qualified for section 1034 treatment but were not entitled to the claimed deductions.

Issue(s)

1. Whether the Bolarises are entitled to defer recognition of gain under section 1034 on the sale of their former residence despite temporarily renting it.
2. Whether the Bolarises are entitled to deductions for depreciation and expenses under sections 162, 167, and 212 for the rental of their former residence.

Holding

1. Yes, because the temporary rental was ancillary to sales efforts and did not

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convert the property from personal use to income-producing use.
2. No, because the rental was not undertaken with the objective of making a profit, thus not qualifying for deductions under sections 162, 167, and 212.

Court's Reasoning

The court relied on Clapham v. Commissioner, which established that temporary rental of a former residence does not preclude section 1034's application if the rental is necessitated by market conditions and ancillary to sales efforts. The Bolarises' situation mirrored Clapham, as they rented due to a lack of offers and maintained efforts to sell. The court emphasized that the Bolarises' primary motive was to sell, not to generate rental income, citing legislative history indicating temporary rentals do not necessarily disqualify section 1034 treatment. However, the court denied deductions under sections 162, 167, and 212, as the rental was not engaged in for profit. The court noted that while successful rental at fair market value typically suggests a profit motive, the Bolarises' actions, including vacating the property to facilitate sales, showed their rental was not for profit. The court distinguished this from property held for investment, which would qualify for deductions.

Practical Implications

This decision clarifies that taxpayers can still defer gain under section 1034 even if they temporarily rent their former residence, provided the rental is ancillary to sales efforts. However, it also warns that such rentals will not qualify for deductions under sections 162, 167, and 212 if not undertaken with a profit motive. Practitioners advising clients on selling their homes should consider this when planning the transition period. The ruling impacts how taxpayers manage the financial aspects of selling a home, particularly in slow markets where temporary rental might be necessary. Subsequent cases, such as R. Joe Rogers v. Commissioner, have distinguished this ruling based on the taxpayer's intent and actions regarding the property. This case remains relevant for understanding the interplay between personal use and income-producing use of property in tax law.

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