Bailey v. Commissioner, 88 T. C. 1293 (1987)

A grant for property improvements is not taxable income if the recipient lacks complete dominion over the improvements.

Summary

Bailey purchased property and participated in an urban renewal facade grant program, receiving a grant for facade restoration without having control over the work. The Tax Court ruled that the grant was not taxable income under the Glenshaw Glass Co. test because Bailey lacked complete dominion over the facade. The court further held that the grant could not be included in the property's basis for depreciation or investment tax credit purposes, as Bailey did not incur any cost for the improvements.

Facts

Bailey purchased property in Pittsburgh, part of an urban renewal project. He participated in a facade grant program where the Urban Redevelopment Authority (URA) restored the facade, and Bailey agreed to rehabilitate the interior and maintain the facade. The URA selected the contractor, negotiated the terms, and paid for the facade work directly. Bailey was not allowed to alter the facade without URA's approval and had to grant URA an easement to enter and repair the facade if necessary. Bailey did not include the $63,121 facade grant in his income but included it in his basis for depreciation and investment tax credit calculations.

Procedural History

The Commissioner of Internal Revenue issued notices of deficiency for Bailey's tax years 1977-1981, asserting that the facade grant was taxable income. Bailey petitioned the U. S. Tax Court, which ruled that the grant was not includable in income but also held that it could not be included in the property's basis or used for investment tax credit.

Issue(s)

1. Whether the facade grant payments are includable in Bailey's gross income under Section 61 of the Internal Revenue Code.
2. Whether the facade grant payments can be included in Bailey's basis in the building.
3. Whether Bailey can claim a depreciation deduction with respect to the facade improvement.
4. Whether Bailey can claim an investment tax credit with respect to the property.

Holding

1. No, because Bailey lacked complete dominion over the facade, the grant was not

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income under the Glenshaw Glass Co. test.
2. No, because Bailey did not incur any cost for the facade improvements, the grant cannot be included in the property's basis.
3. No, because the grant cannot be included in the basis, Bailey's depreciation deductions were incorrectly calculated.
4. No, because the property was used for lodging and did not qualify as a certified historic structure, Bailey was not entitled to an investment tax credit.

Court's Reasoning

The court applied the Glenshaw Glass Co. test, which defines gross income as "accessions to wealth, clearly realized, and over which the taxpayers have complete dominion. " Bailey lacked complete dominion over the facade because the URA controlled the rehabilitation, maintenance, and alteration of the facade. The court rejected the general welfare doctrine argument because the grant was not based on need. The court also distinguished this case from others where taxpayers had control over funds received. The facade grant could not be included in the property's basis because Bailey incurred no cost for the improvements. The court further ruled that the property did not qualify for an investment tax credit because it was used for lodging and was not a certified historic structure.

Practical Implications

This decision clarifies that grants for property improvements are not taxable income if the recipient lacks control over the improvements. Attorneys should advise clients participating in similar programs to understand the level of control they have over the improvements. The ruling also impacts how such grants can be treated for tax purposes, as they cannot be included in the property's basis for depreciation or investment tax credit calculations. This case has been cited in subsequent rulings to determine the taxability of various types of grants and the applicability of the Glenshaw Glass Co. test.

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