De Cou v. Commissioner, 103 T. C. 80 (1994)

A loss from an abnormal retirement of a building due to extraordinary obsolescence is deductible even if the building is later demolished, as long as the loss is not sustained 'on account of' the demolition.

Summary

Charles H. De Cou purchased a building that became unexpectedly obsolete due to hidden structural defects. After the building was withdrawn from use, it was demolished. The IRS disallowed the claimed loss, arguing it was related to the demolition. The Tax Court ruled that the loss was due to the building's extraordinary obsolescence before demolition, thus deductible under sections 165 and 167, and not disallowed under section 280B, which prohibits deductions for losses 'on account of' demolition.

Facts

Charles H. De Cou bought a building in Corpus Christi, Texas, in 1984, intending to renovate and incorporate it into the Water Street Market. In early 1985, significant structural defects were discovered, rendering the building unusable. The building's health permit was suspended, and it was permanently withdrawn from use in June 1985. The building was demolished in October 1985, and De Cou claimed a loss deduction for the building's adjusted basis of $85,987 on his 1985 tax return.

Procedural History

The Commissioner of Internal Revenue disallowed the loss deduction claimed by De Cou. De Cou then petitioned the United States Tax Court for a redetermination of the deficiency. The Tax Court ruled in favor of De Cou, allowing the deduction for the abnormal retirement loss.

Issue(s)

1. Whether a loss sustained due to the abnormal retirement of a building from the taxpayer's business, caused by extraordinary obsolescence, is deductible under sections 165 and 167 despite the building's subsequent demolition.

Holding

1. Yes, because the loss was sustained due to the building's extraordinary obsolescence before its demolition, not 'on account of' the demolition, and thus is not disallowed under section 280B.

Court's Reasoning

The court reasoned that the building's usefulness ended suddenly in April 1985 when defects were discovered, leading to its abnormal retirement in June 1985 due to extraordinary obsolescence. The court emphasized that section 280B disallows losses only if they are sustained ‘on account of’ the demolition, which was not the case here. The court cited IRS Notice 90-21, which supports the deduction of losses from abnormal retirements before demolition. The court rejected the IRS’s argument that De Cou intentionally caused the building’s obsolescence, finding no evidence of willful damage or gross negligence. The court concluded that the loss was deductible under sections 165 and 167 as it was not sustained due to the demolition itself.

Practical Implications

This decision clarifies that losses from abnormal retirements due to extraordinary obsolescence are deductible if they occur before a building’s demolition. Taxpayers should document the timing and cause of a building’s obsolescence to claim such losses. The ruling distinguishes between losses due to demolition (which are not deductible under section 280B) and those due to prior events. Practitioners should advise clients to carefully assess and document the condition of properties before demolition to support claims for abnormal retirement losses. Subsequent cases like *Tonawanda Coke Corp. v. Commissioner* have cited this decision to clarify the application of section 280B.