

1940

TAXATION - INCOME TAX - INTEREST ON CONDEMNATION AWARD AS CAPITAL GAIN

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Recommended Citation

John L. Rubsam, *TAXATION - INCOME TAX - INTEREST ON CONDEMNATION AWARD AS CAPITAL GAIN*, 39 MICH. L. REV. 169 (1940).

Available at: <https://repository.law.umich.edu/mlr/vol39/iss1/23>

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TAXATION — INCOME TAX — INTEREST ON CONDEMNATION AWARD AS CAPITAL GAIN — Petitioner's land was condemned by the city of New York and as compensation he was awarded a certain sum representing the value of the land and, in addition, a sum classified as "interest" to indemnify the petitioner for delay in payment of the award. The award so classified as "interest" was taxed as "ordinary income" by the commissioner of internal revenue. It was petitioner's contention that such sum denominated as "interest" should have been classed as a "capital gain" and not as "ordinary income." From an order of the board of tax appeals holding this sum "ordinary income," petitioner appealed. *Held*, that portion of the award which was denominated "interest" was a part of the condemnation award and should be classed as "capital gain" and not "ordinary income." *Seaside Improvement Co. v. Commissioner of Internal Revenue*, (C. C. A. 2d, 1939) 105 F. (2d) 990.¹

Interest on a condemnation award is not interest on an obligation of a political subdivision of a state, and, therefore, is not exempt from taxation.² The question here involved is not whether such "interest" is exempt from taxation altogether, but rather whether it should be included as "ordinary income" or "capital gain" for income tax purposes. The usual import of the term "interest" within the Revenue Act is the amount which one has contracted to pay for the use of borrowed money. The Supreme Court has said that in determining whether a taxpayer's payments constituted "interest on indebtedness" deductible in computing net income, it assumed that Congress used the quoted words in a sense in which they are used in the business world and that "interest on indebtedness" means "compensation for the use or forbearance of money."³ It has also been held that a receipt of interest is taxable as income whether received in cash or by credit.⁴ However, in all the above mentioned cases the "interest" was a

¹ This case involved many parties and questions regarding damages, cost basis and valuation of property. It is the purpose of this note to cover only the question of "interest" as "ordinary income" or "capital gain." It should also be noted that this question concerns only individual taxpayers, since corporate taxpayers are taxable at the same rate no matter how the question is decided, Revenue Act of 1928, § 101, 45 Stat. L. 797, reenacted by Internal Revenue Code of 1939, 53 Stat. L. 50, 26 U. S. C. (Supp. 1939), § 117.

² *Bliss v. Commissioner*, 27 B. T. A. 803 (1933); *United States Trust Co. v. Anderson*, (C. C. A. 2d, 1933) 65 F. (2d) 575, cert. den. 290 U. S. 683, 54 S. Ct. 120 (1933).

³ *Deputy v. DuPont*, 308 U. S. 488, 60 S. Ct. 363 (1940); *Old Colony R. R. v. Commissioner of Internal Revenue*, 284 U. S. 522, 52 S. Ct. 211 (1932).

⁴ *Helvering v. Midland Mut. Life Ins. Co.*, 300 U. S. 216, 57 S. Ct. 423 (1937), holding that where an insurance company bid in property on foreclosure of mortgage for full amount of the principal and interest, it was subject to income taxation on the interest portion of its bid.

form of compensation for the use of money or property in a business sense. In the present case the designation of part of the award as "interest" does not per se put it in the above classification. It is well settled that the United States, upon claims made against it, cannot in the absence of a statute to that end, be subjected to the payment of interest.⁵ But in condemnation proceedings where the United States has appropriated lands, it is duty bound to make just compensation as of the time when the owners were deprived of their property, and the allowance of interest from the time of taking until payment is a convenient and fair method of ascertaining the sum to which the owner of the land is entitled.⁶ In this type of case it has been held that the rule disallowing interest against the United States is inapplicable. In *Seaboard Air Line Ry. v. United States*,⁷ the Court said: "Where the United States condemns and takes possession of land before ascertaining or paying compensation, the owner is not limited to the value of the property at the time of the taking; he is entitled to such addition as will produce the full equivalent of that value paid contemporaneously with the taking. Interest at a proper rate is a good measure by which to ascertain the amount so to be added." Following this decision it has always been held that the compensation in such cases shall include interest, not as interest per se but as a part of the damages in the award.⁸ And the right to this additional sum attaches automatically to the right to an award of damages.⁹ In the instant case it is clear that the court properly held that the sum so designated as interest was not "ordinary income" or the usual business man's conception of "interest" but in fact a "capital gain" as being a part of the award to indemnify the individuals for the property condemned.¹⁰

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⁵ *United States ex rel. Angarica v. Bayard*, 127 U. S. 251, 8 S. Ct. 1156 (1887); *United States v. North Carolina*, 136 U. S. 211, 10 S. Ct. 920 (1889).

⁶ *United States v. Rogers*, 255 U. S. 163, 41 S. Ct. 281 (1921).

⁷ 261 U. S. 299 at 306, 43 S. Ct. 354 (1923).

⁸ *Brooks-Scanlon Corp. v. United States*, 265 U. S. 106, 44 S. Ct. 471 (1924); *Phelps v. United States*, 274 U. S. 341, 47 S. Ct. 611 (1927). The syllabus of *Liggett & Myers Tobacco Co. v. United States*, 274 U. S. 215, 47 S. Ct. 581 (1921), states: "For property not paid for when taken, just compensation includes the value at that time, with enough more, measurable by interest, to produce the equivalent of full value paid at the taking."

⁹ *Shoshone Tribe of Indians v. United States*, 299 U. S. 476, 57 S. Ct. 244 (1937).

¹⁰ In a recent case, *Williams Land Co. v. United States*, (Ct. Cl. 1940) 31 F. Supp. 153, the court held that "interest" paid by the city of Detroit in connection with awards for the condemnation of realty for street widening purposes was not exempt from tax as interest upon the obligation of a political subdivision of a state. It should be noted that this was a claim for *exemption* of taxes and did not involve the distinction between "capital gain" and "ordinary income" as in the present case. It should also be noted that in the *Williams Land Co.* case the interest collected in 1934 should be added to the collection made on the principal and that no income should be deemed to be realized unless there is a net taxable gain on the condemnation.