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Taxation - Federal Income Tax - Severance Damages to Real Property are a Component of Charitable Deduction

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TAXATION—FEDERAL INCOME TAX—SEVERANCE DAMAGES TO REAL PROPERTY ARE A COMPONENT OF CHARITABLE DEDUCTION—The United States selected part of petitioners' estate for construction of a Nike missile base and began condemnation proceedings and negotiations for sale of the premises in lieu of condemnation. Upon failure of the parties to agree on a sale price, petitioners made a gift of the site and certain easements in adjoining land to the United States for so long as the site was used as a missile base. In their 1955 return petitioners claimed a charitable deduction of \$69,782 as the fair market value, including severance damages to the remaining portion of their estate, of the property conveyed. The Government allowed a deduction of only \$1,200 for the land conveyed.¹ In a deficiency proceeding before the Tax Court, *held*, petitioners are entitled to a deduction of \$69,961.² Severance damages are an intrinsic part of the fair market value of property contributed. *Benjamin Klopp*, 29 P-H Tax Ct. Mem. 1084 (1960).

¹ INT. REV. CODE OF 1954, § 170 (c), allows a deduction for a "contribution or gift to or for the use of— (1) a State, a Territory, a possession of the United States, or any political subdivision of any of the foregoing, or the United States or the District of Columbia, but only if the contribution or gift is made for exclusively public purposes." In the principal case it was stipulated that the petitioners' gift qualified under this provision and the question was narrowed to one of valuation.

² The court made an evaluation based upon certain findings of fact and an appraisal of the property involved. It also stated that the possibility that the Government would eventually abandon the premises as a missile base was not so remote that it could be ignored and thus made an adjustment for the petitioners' reversion. The final figure reflects this adjustment and the ceiling imposed by INT. REV. CODE OF 1954, § 170 (b), on the amount of a charitable deduction.

When a portion of a tract of land is taken by the government through its eminent domain power, the remaining portion of the tract frequently suffers a decrease in value as a result of its inadaptability to certain uses,³ or by virtue of the use to which the condemned portion is to be put.⁴ To compensate the owner for this loss the government is compelled to pay severance damages in addition to the value of the portion condemned.⁵ But even though this is the rule pertaining to an award in condemnation proceedings, the question remains whether a measure of value applied in the case of a seizure by the government is an appropriate measure in the case of a charitable donation of the same property.⁶ The Tax Court here holds this to be the proper measure, and although it relies on condemnation cases exclusively, it bases the decision on an inflexible view of the fair market value concept.⁷

Three objections are suggested to this broad proposition advanced by the court. But while they may tend to dispute the idea that sale, gift, and condemnation are indistinct, each remains an effective argument in favor of the result reached in this case. The first such objection is that no property has passed to the Government as donee which would represent the amount of severance damages. But although a charity must ordinarily receive something to justify a charitable deduction, there is an exception in the analogous situation of the charitable volunteer who may deduct unreimbursed expenses⁸ on the theory that the donee charity has been spared an expense it would otherwise have to meet to secure the same benefits.⁹

³ Baetjer v. United States, 143 F.2d 391, 396 (1st Cir. 1944).

⁴ Sharp v. United States, 191 U.S. 341, 352 (1903); West Virginia Pulp & Paper Co. v. United States, 200 F.2d 100 (4th Cir. 1952).

⁵ United States v. Grizzard, 219 U.S. 180, 183-85 (1911); Sharp v. United States, *supra* note 4; West Virginia Pulp & Paper Co. v. United States, *supra* note 4; United States v. Dickinson, 152 F.2d 865 (4th Cir. 1946), *aff'd*, 331 U.S. 745 (1947); Baetjer v. United States, *supra* note 3; JAHR, EMINENT DOMAIN, VALUATION AND PROCEDURE § 50 (1953); McCORMICK, DAMAGES 527-30 (1935). It is clear that severance damages will be awarded only where the condemned portion and that remaining constituted one unitary holding, that is, where the parcels taken together had been treated as an integrated whole put to a common use, and not as separate or independent, although adjoining, tracts.

⁶ The government's position in this matter is not clear from the opinion. However, it does appear that the Government argued that petitioners' estate was not a unitary holding such as would qualify for severance damages. Even this position may not have been strongly urged since the court rejects it with only passing consideration. Principal case at 1088.

⁷ "Fair market value is a constant, not a variable; it does not fluctuate according to whether condemnation, sale, or gift is involved." Principal case at 1089. The Regulations provide: "If a contribution is made in property other than money, the amount of the deduction is determined by the fair market value of the property at the time of the contribution." Treas. Reg. § 1.170-1 (c) (1958).

⁸ For example, the delegate to a church convention deducts transportation costs. Rev. Rul. 58-240, 1958-1 CUM. BULL. 141. The expense of Red Cross uniforms may be similarly deducted. Rev. Rul. 56-508, 1956-2 CUM. BULL. 126.

⁹ And while the petitioners have not sustained an out-of-pocket expense, they have absorbed the loss represented by the decrease in value of the property retained.

A second objection is that severance has been the result of the taxpayer's voluntary act and *volenti non fit injuria*. The term "damages" is surely appropriate in the case of a seizure, but not in the context of the charitable gift or sale. This is not merely a question of semantics because, except in peculiar circumstances, in neither the sale nor the gift does the owner of the property know the intended use to which his transferee will put the premises, or the extent of any injury which may result to the remainder of his holding. In the principal case, however, because the transaction was made in the face of imminent condemnation, the taxpayer knows both the source and the extent of his injury.¹⁰ Severance damages clearly can be treated as an element of the value of the property in this context.

Finally, there is a distinction between the tax consequences of a sale and condemnation award which the formula of the court tends to ignore. That portion of a condemnation award which can be isolated as severance damages may be applied against the basis of the land retained.¹¹ There does not appear to be authority for affording similar treatment to the proceeds of a voluntary sale, even if severance damages are known at the time of the sale. But as an alternative to seizure, this was not a voluntary disposition by petitioners and the distinction should not be an obstacle to allowing the deduction. On its facts, the decision is justifiable under the court's analogy to actual condemnation and on sound policy grounds.¹²

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¹⁰ This is not to say that a land owner who sells a portion of his holding may not later be injured by the severance. But typically in a sale severance damages are absorbed in the price which the seller seeks, and if this information is not known to him at the time he sells the land, he will not make this adjustment.

¹¹ *Pioneer Real Estate Co. v. Commissioner*, 47 B.T.A. 886 (1942). What effect this decision will have on the basis of that land retained by petitioners was not before the court. However, the fact that petitioners elected to donate the severance damages and take the deduction instead of receiving the award in cash should make no difference; hence it may be presumed that the basis of that land retained is reduced by the amount of severance damages claimed as a deduction.

¹² The decision clearly does not go so far as to authorize such favorable tax treatment of severance damages in an ordinary sale merely on the strength of a label attached to part of the price by the parties. By analogizing from the authority of the condemnation cases, the court has made it clear that some threat of condemnation must be present. On the other hand, the decision might very well be extended to cover a situation where a landowner, faced with the possibility that his land might be taken, is able to negotiate a settlement with the state. If severance damages would have been an appropriate element and a portion of the price paid is attributable to these severance damages, the owner ought to have the benefit of *Pioneer Real Estate Co. v. Commissioner*, *supra* note 11.