Revenue Ruling 74-104

Section 263. Capital Expenditures

January 1974

Evaluation expenditures in connection with acquisitions of residential property. Evaluation expenditures incurred by a domestic corporation in connection with the acquisition of existing residential property for renovation and resale are capital expenditures that must be taken into account as part of the cost of acquiring the property. However, if such expenditures do not result in the acquisition of property they are deductible as losses in the taxable year the corporation decides not to acquire the property.

The taxpayer is a domestic corporation in the business of acquiring existing residential property to renovate and subsequently sell to the general public. Prior to acquiring property for renovation, the taxpayer incurs expenditures in evaluating a potential locality to determine the feasibility of selling such property in the locality. The evaluation expenditures include the cost of securing an initial report from an independent agent, and salaries, travel, and other related costs subsequently incurred by the taxpayer in evaluating the agent's report and the locality involved.

Section 263 of the Internal Revenue Code of 1954 provides, in part, that no deduction shall be allowed for any amounts paid out for new buildings or for permanent improvements or betterments made to increase the value of any property or estate.

Section 1.263 (a)-2 of the Income Tax Regulations provides, in part, that capital expenditures include the cost of acquisition, construction, or erection of buildings, machinery and equipment, furniture and fixtures, and similar property having a useful life substantially beyond the taxable year.

Held, since the taxpayer is in the trade or business of acquiring residential property for renovation and sale and since the evaluation expenditures are incurred by the taxpayer in connection with acquiring existing residential property and are of benefit beyond the current taxable year through the sale of the renovated property, such expenditures are capital expenditures under section 263 of the Code that must properly be taken into account as part of the cost of acquiring the property. However, if the evaluation expenditures do not result in the acquisition of property for renovation, such expenditures are deductible under section 165 (concerning losses) in the taxable year that the taxpayer decides not to acquire the property.