

from the sale or exchange of capital assets do not apply to losses allowable under this section.

(c) *Cross references.* For the allowance under section 165(a) of losses arising from the permanent withdrawal of depreciable property from use in the trade or business or in the production of income, see § 1.167(a)-8. For provisions respecting the obsolescence of depreciable property, see § 1.167(a)-9. For the allowance of casualty losses, see § 1.165-7.

**§ 1.165-3 Demolition of buildings.**

(a) *Intent to demolish formed at time of purchase.* (1) Except as provided in subparagraph (2) of this paragraph, the following rule shall apply when, in the course of a trade or business or in a transaction entered into for profit, real property is purchased with the intention of demolishing either immediately or subsequently the buildings situated thereon: No deduction shall be allowed under section 165(a) on account of the demolition of the old buildings even though any demolition originally planned is subsequently deferred or abandoned. The entire basis of the property so purchased shall, notwithstanding the provisions of § 1.167(a)-5, be allocated to the land only. Such basis shall be increased by the net cost of demolition or decreased by the net proceeds from demolition.

(2)(i) If the property is purchased with the intention of demolishing the buildings and the buildings are used in a trade or business or held for the production of income before their demolition, a portion of the basis of the property may be allocated to such buildings and depreciated over the period during which they are so used or held. The fact that the taxpayer intends to demolish the buildings shall be taken into account in making the apportionment of basis between the land and buildings under § 1.167(a)-5. In any event, the portion of the purchase price which may be allocated to the buildings shall not exceed the present value of the right to receive rentals from the buildings over the period of their intended use. The present value of such right shall be determined at the time that the buildings are first used in the trade or business or first held for the

production of income. If the taxpayer does not rent the buildings, but uses them in his own trade or business or in the production of his income, the present value of such right shall be determined by reference to the rentals which could be realized during such period of intended use. The fact that the taxpayer intends to rent or use the buildings for a limited period before their demolition shall also be taken into account in computing the useful life in accordance with paragraph (b) of § 1.167(a)-1.

(ii) Any portion of the purchase price which is allocated to the buildings in accordance with this subparagraph shall not be included in the basis of the land computed under subparagraph (1) of this paragraph, and any portion of the basis of the buildings which has not been recovered through depreciation or otherwise at the time of the demolition of the buildings is allowable as a deduction under section 165.

(iii) The application of this subparagraph may be illustrated by the following example:

*Example.* In January 1958, A purchased land and a building for \$60,000 with the intention of demolishing the building. In the following April, A concludes that he will be unable to commence the construction of a proposed new building for a period of more than 3 years. Accordingly, on June 1, 1958, he leased the building for a period of 3 years at an annual rental of \$1,200. A intends to demolish the building upon expiration of the lease. A may allocate a portion of the \$60,000 basis of the property to the building to be depreciated over the 3-year period. That portion is equal to the present value of the right to receive \$3,600 (3 times \$1,200). Assuming that the present value of that right determined as of June 1, 1958, is \$2,850, A may allocate that amount to the building and, if A files his return on the basis of a taxable year ending May 31, 1959, A may take a depreciation deduction with respect to such building of \$950 for such taxable year. The basis of the land to A as determined under subparagraph (1) of this paragraph is reduced by \$2,850. If on June 1, 1960, A ceases to rent the building and demolishes it, the balance of the undepreciated portion allocated to the buildings, \$950, may be deducted from gross income under section 165.

(3) The basis of any building acquired in replacement of the old buildings shall not include any part of the basis of the property originally purchased

even though such part was, at the time of purchase, allocated to the buildings to be demolished for purposes of determining allowable depreciation for the period before demolition.

(b) *Intent to demolish formed subsequent to the time of acquisition.* (1) Except as provided in subparagraph (2) of this paragraph, the loss incurred in a trade or business or in a transaction entered into for profit and arising from a demolition of old buildings shall be allowed as a deduction under section 165(a) if the demolition occurs as a result of a plan formed subsequent to the acquisition of the buildings demolished. The amount of the loss shall be the adjusted basis of the buildings demolished increased by the net cost of demolition or decreased by the net proceeds from demolition. See paragraph (c) of §1.165-1 relating to amount deductible under section 165. The basis of any building acquired in replacement of the old buildings shall not include any part of the basis of the property demolished.

(2) If a lessor or lessee of real property demolishes the buildings situated thereon pursuant to a lease or an agreement which resulted in a lease, under which either the lessor was required or the lessee was required or permitted to demolish such buildings, no deduction shall be allowed to the lessor under section 165(a) on account of the demolition of the old buildings. However, the adjusted basis of the demolished buildings, increased by the net cost of demolition or decreased by the net proceeds from demolition, shall be considered as a part of the cost of the lease to be amortized over the remaining term thereof.

(c) *Evidence of intention.* (1) Whether real property has been purchased with the intention of demolishing the buildings thereon or whether the demolition of the buildings occurs as a result of a plan formed subsequent to their acquisition is a question of fact, and the answer depends upon an examination of all the surrounding facts and circumstances. The answer to the question does not depend solely upon the statements of the taxpayer at the time he acquired the property or demolished the buildings, but such statements, if made, are relevant and will be consid-

ered. Certain other relevant facts and circumstances that exist in some cases and the inferences that might reasonably be drawn from them are described in subparagraphs (2) and (3) of this paragraph. The question as to the taxpayer's intention is not answered by any inference that is drawn from any one fact or circumstance but can be answered only by a consideration of all relevant facts and circumstances and the reasonable inferences to be drawn therefrom.

(2) An intention at the time of acquisition to demolish may be suggested by:

(i) A short delay between the date of acquisition and the date of demolition;

(ii) Evidence of prohibitive remodeling costs determined at the time of acquisition;

(iii) Existence of municipal regulations at the time of acquisition which would prohibit the continued use of the buildings for profit purposes;

(iv) Unsuitability of the buildings for the taxpayer's trade or business at the time of acquisition; or

(v) Inability at the time of acquisition to realize a reasonable income from the buildings.

(3) The fact that the demolition occurred pursuant to a plan formed subsequent to the acquisition of the property may be suggested by:

(i) Substantial improvement of the buildings immediately after their acquisition;

(ii) Prolonged use of the buildings for business purposes after their acquisition;

(iii) Suitability of the buildings for investment purposes at the time of acquisition;

(iv) Substantial change in economic or business conditions after the date of acquisition;

(v) Loss of useful value occurring after the date of acquisition;

(vi) Substantial damage to the buildings occurring after their acquisition;

(vii) Discovery of latent structural defects in the buildings after their acquisition;

(viii) Decline in the taxpayer's business after the date of acquisition;

(ix) Condemnation of the property by municipal authorities after the date of acquisition; or

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(x) Inability after acquisition to obtain building material necessary for the improvement of the property.

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#### § 1.165-4 Decline in value of stock.

(a) *Deduction disallowed.* No deduction shall be allowed under section 165(a) solely on account of a decline in the value of stock owned by the taxpayer when the decline is due to a fluctuation in the market price of the stock or to other similar cause. A mere shrinkage in the value of stock owned by the taxpayer, even though extensive, does not give rise to a deduction under section 165(a) if the stock has any recognizable value on the date claimed as the date of loss. No loss for a decline in the value of stock owned by the taxpayer shall be allowed as a deduction under section 165(a) except insofar as the loss is recognized under § 1.1002-1 upon the sale or exchange of the stock and except as otherwise provided in § 1.165-5 with respect to stock which becomes worthless during the taxable year.

(b) *Stock owned by banks.* (1) In the regulation of banks and certain other corporations, Federal and State authorities may require that stock owned by such organizations be charged off as worthless or written down to a nominal value. If, in any such case, this requirement is premised upon the worthlessness of the stock, the charging off or writing down will be considered prima facie evidence of worthlessness for purposes of section 165(a); but, if the charging off or writing down is due to a fluctuation in the market price of the stock or if no reasonable attempt to determine the worthlessness of the stock has been made, then no deduction shall be allowed under section 165(a) for the amount so charged off or written down.

(2) This paragraph shall not be construed, however, to permit a deduction under section 165(a) unless the stock owned by the bank or other corporation actually becomes worthless in the taxable year. Such a taxpayer owning stock which becomes worthless during the taxable year is not precluded from deducting the loss under section 165(a)

merely because, in obedience to the specific orders or general policy of such supervisory authorities, the value of the stock is written down to a nominal amount instead of being charged off completely.

(c) *Application to inventories.* This section does not apply to a decline in the value of corporate stock reflected in inventories required to be taken by a dealer in securities under section 471. See § 1.471-5.

(d) *Definition.* As used in this section, the term "stock" means a share of stock in a corporation or a right to subscribe for, or to receive, a share of stock in a corporation.

#### § 1.165-5 Worthless securities.

(a) *Definition of security.* As used in section 165(g) and this section, the term "security" means:

- (1) A share of stock in a corporation;
- (2) A right to subscribe for, or to receive, a share of stock in a corporation; or
- (3) A bond, debenture, note, or certificate, or other evidence of indebtedness to pay a fixed or determinable sum of money, which has been issued with interest coupons or in registered form by a domestic or foreign corporation or by any government or political subdivision thereof.

(b) *Ordinary loss.* If any security which is not a capital asset becomes wholly worthless during the taxable year, the loss resulting therefrom may be deducted under section 165(a) as an ordinary loss.

(c) *Capital loss.* If any security which is a capital asset becomes wholly worthless at any time during the taxable year, the loss resulting therefrom may be deducted under section 165(a) but only as though it were a loss from a sale or exchange, on the last day of the taxable year, of a capital asset. See section 165(g)(1). The amount so allowed as a deduction shall be subject to the limitations upon capital losses described in paragraph (c)(3) of § 1.165-1.

(d) *Loss on worthless securities of an affiliated corporation—(1) Deductible as an ordinary loss.* If a taxpayer which is a