Balso Foundation v. United States of America
80-2 USTC ¶9581

[Code Sec. 4940]

Private foundation: Excise tax on investment income: Sale of real estate: Capital gain.--The court denied cross motions for summary judgment because on the facts before it the court could not find that the taxpayer was or was not liable for excise tax on investment income resulting from the sale of real estate. The real estate that was sold was unimproved wooded land that the foundation-taxpayer had previously acquired by gift, and the IRS argued that the excise tax was applicable because the land was rental property. The taxpayer argued that it was not rental property and questioned the validity of a regulation stating that capital gains through the appreciation of such property were taxable. The court held that although the taxpayer showed that the land was unused for an extended period before the sale, it did not negate with the certainty necessary for summary judgment the land's potential rental value, especially in light of the fact that the land had been leased as a Girl Scout camp, albeit at a nominal rent. Therefore, the court would not grant summary judgment or consider the validity of the regulation. BACK REFERENCES: 80FED ¶4997B.20.

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Ruling on Cross-Motions for Summary Judgment

LATIMER, U. S. Magistrate:

In this civil action for a $10,000 tax refund, cf. 28 U. S. C. §1346(a)(1), the plaintiff foundation contests imposition of excise tax liability for its 1973 sale of some 51.42 acres of unimproved wooded land in Cheshire, Connecticut previously acquired by gift. As a qualifying charitable organization, plaintiff is generally exempt from federal income taxation, cf. 26 U. S. C. §501(c)(3)--save for "unrelated business" income, cf. 26 U. S. C. §511--but may be subjected to an *excise* tax on investment income, cf. 26 U. S. C. §4940. Although that investment income category includes capital gains, the controlling statute provides in relevant part that "[t]here shall be taken into account only gains from the sale . . . of property used for the production of interest, dividend, rents, and royalties", plus "property used for the production of [unrelated business] income", 26 U. S. C. §4940(c)(4)(A). On cross-motions for summary judgment, plaintiff essentially contends that its property was simply not of any such character.

At the core of the parties' dispute is the more inclusively worded treasury regulation adopted to implement that aspect of the statute, 26 C. F. R. §53.4940-1(f)(1). Federal taxing authorities certainly have broad power to "prescribe all needful rules and regulations for the enforcement of" the Internal Revenue Code, 26 U. S. C. §7805(a), and courts defer to any reasonable administrative approach not flatly inconsistent with the underlying statute, see, *e.g.*, *Nat'l*

Muffler Dealers Ass'n v. United States [79-1 USTC ¶9264], 440 U. S. 472, 476-477 (1979), *cf.* also *Commissioner v. South Texas Lumber Co.* [48-1 USTC ¶5922], 333 U. S. 496, 501 (1948). Plaintiff does suggest that to sanction the government's resort to the regulation in suit would violate §4940's "plain terms", *Helvering v. Sabine Transportation Co.* [43-1 USTC ¶9317], 318 U. S. 306, 311-312 (1943).

As just noted, the literal reach of §4940(c)(4)(A) extends "only" to capital gains from disposition of "property used for the production of interest, dividends, rents, and royalties", or for the production of "unrelated business" income. That description of property deemed held for taxable investment income purposes has been "interpreted" by 26 C. F. R. §53.4940-1(f)(1) as follows:

> "For taxable years beginning after December 31, 1972, property shall be treated as held for investment purposes even though such property is disposed of by the foundation immediately upon its receipt, if it is property of a type which generally produces interest, dividends, rents, royalties, *or capital gains through appreciation* (for example, rental real estate, stock, bonds, mineral interests, mortgages, and securities)." [emphasis added]

The evidence of record tends to show that plaintiff made no use whatsoever of its Cheshire land during the approximate 17 months of ownership between gift receipt and disposition by sale to a development company--nor did that wooded acreage yield plaintiff any income in the form of "interest, dividends, rents . . . [or] royalties". Indeed, the *prior* owner's 25-year holding itself may have involved no usage other than some years' permitted use by the Girl Scouts as a summer day camp site under a $1.00 per year lease arrangement, nominal payments conceivably never made. Relying on §53.4940-1(f)(1), the government's disallowance of plaintiff's refund claim has rested on the explicit premise that "[l]and is property of a type which generally produces rents and/or capital gains through appreciation". In turn expressly assuming that its undeveloped parcel at least could not be properly termed *rental* property, plaintiff focuses on the government's §53.4940-1(a)(1) "addition" of a "capital gains through appreciation" category of property to §4940's apparently more limited terms. Such action, plaintiff urges, is no authorized provision of needed definitional content to the Code, compare, e.g., *United States v. Correll* [68-1 USTC ¶9101], 389 U. S. 299 (1967), cf. also *Fulman v. United States* [78-1 USTC ¶9247], 434 U. S. 528, 533 (1978), but represents instead a patently invalid attempt to amend §4940 through disregard of the statute's unambiguously restricted scope.

Since a treasury regulation may not be struck down absent "weighty reasons", *Commissioner v. South Texas Lumber Co., supra* at 501, it may bear initial note that genuine understanding of even seeming "plain meaning" can properly involve study of the statute's context, cf. *Allen Oil Co. v. Commissioner* [80-2 USTC ¶9156], 614 F. 2d 336 (2 Cir. 1980), so that government counsel has appropriately offered comment on §4940's background and setting. As is often the case, however, legislative history and purpose are not crystal clear. For example, the very committee report that speaks of capital gains as "included in full in the base for this tax" then remarks that "the capital gains . . . to be taken into account are only those on capital assets used to produce income subject to this tax"-- i.e., interest, dividends, rents, and royalties--or on capital assets "used to compute the tax on unrelated business income". H. R. Rep. No. 91-413 (Part 1), 91st Cong., 1st Sess. pp. 19-20 (1969-3 Cum. Bull. 200, 213-214).

In this last regard, it will be recalled that the exempt charity is subject to federal tax on *income* from "unrelated business", see 26 U. S. C. §511, *et seq.,* and the §4940 *excise* measure also looks to "unrelated business" income-producing property. On the other hand, that express §4940 mention of another type of property along with those which produce "interest, dividends, rents, and royalties" is not easily equated with the government's more sweeping §53.4940-1(f)(1) position that *all* "property of a type which generally produces . . . capital gains through appreciation" is appropriately included.

On the actual record presented, however, it would seem unwise for quite a different reason to voice any purported final assessment of the parties' substantive legal contentions in a matter of such potential general consequence. Plaintiff would appear to concede that capital gain from sale of land "of a type which generally produces . . . rents" can be validly taxed, but maintains that its undeveloped Cheshire property was patently not of that "type". The question for immediate purposes is not just whether plaintiff's evidence is *persuasive,* but whether its acceptance involves any element of fact-finding--a prohibited step in these pretrial motion proceedings, see, *e.g., Heyman v. Commerce & Industry Ins. Co.,* 524 F. 2d 1317, 1319-1320 (2 Cir. 1975). Government counsel by no means agrees that the issue of rental potential can be resolved purely "as a matter of law", Rule 56(c), Fed. R. Civ. P., and this threshold procedural question is of larger significance in at least two respects. In the first place, a taxpayer plaintiff sustained on doubtful motion record merely prompts procedurally oriented government appeal, and may well have created adjudication of the merits. If decision on the merits is affected by any conclusion identified as a choice of inferences, moreover, the choice fully informed by trial hearing context may prove "unexpected" from a prior reading of but the documentary record on motion; here, such an "unexpected" trial ruling against plaintiff on rental character of its land would be dispositive, rendering moot any purported analysis of the regulation's validity in other respects.

The question again is whether that potentially dispositive issue poses any choice between permissible inferences, see *Heyman, supra* at 1320, with plaintiff strictly held to establish the contrary, lest trial safeguards be denied, see *id.* at 1320. The land's description and usage information as sketched above were given by a foundation trustee, Donald H. Davis, through interrogatory answers, affidavit and brief deposition testimony. Assuming the accuracy of his summary characterization of the property as virtually unused forest land during an extended period before sale in 1973, the land's rental potential still has not been negated with requisite certainty for present purposes. However nominal, after all, the Girl Scout camp lease arrangement alone did indicate *some* interest in use of the wooded parcel, land which conceivably might have supported many recreational and even commercial uses on a fee-paying basis in its wooded state. If forceful, in short, plaintiff's view of the property's non-rental character is perhaps not inevitable.

To rule on the regulation's disputed validity now would appear improvident in the circumstances; supposed pretrial disposition of that important public issue would not be sufficient to vindicate this plaintiff's cause, and might also prove unnecessary to the defendant's. The pending cross-motions for summary judgment are accordingly hereby denied on the existing record, without prejudice to continued assertion of the parties' opposing claims of law in the context of ensuing trial proceedings.